ISSUES ARISING UNDER THE PAYMENT-IN-KIND PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 1296

TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO ALLOW ANY TAXPAYER TO ELECT TO TREAT FOR INCOME TAX PURPOSES ANY CROP RECEIVED UNDER A FEDERAL PROGRAM FOR REMOVING LAND FROM AGRICULTURAL PRODUCTION AS PRODUCED BY THE TAXPAYER, TO ALLOW ANY TAXPAYER TO ELECT TO DEFER INCOME ON ANY CANCELLATION UNDER SUCH A PROGRAM OF ANY PRICE SUPPORT LOAN, AND TO PROVIDE THAT PARTICIPATION IN SUCH A PROGRAM SHALL NOT DISQUALIFY THE TAXPAYER FOR THE SPECIAL USE VALUATION OF FARM REAL PROPERTY UNDER SECTION 2032A OF SUCH CODE

FEBRUARY 23, 1983

Serial 98–9

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

19-423 O WASHINGTON : 1983

H781-27

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J. J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY H. (PETE) STARK, California
JAMES R. JONES, Oklahoma
ANDY JACOBS, JR., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
CECIL (CEC) HEFTEL, Hawaii
WYCHE FOWLER, JR., Georgia
FRANK J. GUARINI, New Jersey
JAMES M. SHANNON, Massachusetts
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
KENT HANCE, Texas
ROBERT T. MATSUI, California
BERYL ANTHONY, JR., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut

BARBER B. CONABLE, JR., New York
JOHN J. DUNCAN, Tennessee
BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
JAMES G. MARTIN, North Carolina
RICHARD T. SCHULZE, Pennsylvania
BILL GRADISON, Ohio
W. HENSON MOORE, Louisiana
CARROLL A. CAMPBELL, JR., South Carolina
WILLIAM M. THOMAS, California

JOHN J. SALMON, *Chief Counsel*
JOSEPH K. DOWLEY, *Assistant Chief Counsel*
ROBERT J. LEONARD, *Chief Tax Counsel*
A. L. SINGLETON, *Minority Chief of Staff*

SUBCOMMITTEE ON SELECT REVENUE MEASURES

FORTNEY H. (PETE) STARK, California, *Chairman*

CECIL (CEC) HEFTEL, Hawaii
FRANK J. GUARINI, New Jersey
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut
ED JENKINS, Georgia

JOHN J. DUNCAN, Tennessee
RICHARD T. SCHULZE, Pennsylvania
GUY VANDER JAGT, Michigan
W. HENSON MOORE, Louisiana

JAYNE BOYLE, *Professional Staff*
JOHN JONAS, *Professional Staff*

CONTENTS

Page

Press releases announcing the hearing 1
H.R. 1296, text 4

WITNESSES

Department of the Treasury, Hon. John E. Chapoton, Assistant Secretary for Tax Policy 9
Department of Agriculture, Hon. Richard Lyng, Deputy Secretary; Dawson Ahalt, Acting Deputy Under Secretary for International Programs and Commodity Programs; and A. James Barnes, General Counsel 28

American Farm Bureau Federation, Grace Ellen Rice 65
Bedell, Hon. Berkley, a Representative in Congress from the State of Iowa 53
Bellatti, Robert, Springfield, Ill 56
Davidson, Dick, Illinois Department of Agriculture 62
Durbin, Hon. Richard J., a Representative in Congress from the State of Illinois, accompanied by Robert Bellatti 56
Ethridge, Dean, National Cotton Council of America 73
Evans, Hon. Cooper, a Representative in Congress from the State of Iowa 59
Frazier, Charles L., National Farmers Organization 77
Graham, Don E., National Council of Farmer Cooperatives 75
Hance, Hon. Kent, a Representative in Congress from the State of Texas 45
Harkin, Hon. Tom, a Representative in Congress from the State of Iowa 47
Harl, Prof. Neil E., Iowa State University 67
Illinois Department of Agriculture, Larry A. Werries and Dick Davidson 62
Kapp, Robert H., National Farmers Organization 77
National Cotton Council of America, James H. Sanford and Dean Ethridge 73
National Council of Farmer Cooperatives, Don E. Graham and Bill F. Sims 75
National Farmers Organization, Charles L. Frazier and Robert H. Kapp 77
Rice, Grace Ellen, American Farm Bureau Federation 65
Sanford, James H., National Cotton Council of America 73
Sims, Bill F., National Council of Farmer Cooperatives 75
Smith, Hon. Virginia, a Representative in Congress from the State of Nebraska 55
Stenholm, Hon. Charles W., a Representative in Congress from the State of Texas 52
Werries, Larry A., Illinois Department of Agriculture 62

SUBMISSIONS FOR THE RECORD

Agriculture, House Committee on, Hon. E (Kika) de la Garza, Chairman, a Representative in Congress from the State of Texas, and Hon. Edward R. Madigan, Ranking Minority Member, a Representative in Congress from the State of Illinois, joint letter 81
American Cotton Shippers Association, Samuel T. Reeves, letter 85
Coleman, Hon. E. Thomas, a Representative in Congress from the State of Missouri, statement 82
Daschle, Hon. Thomas A., a Representative in Congress from the State of South Dakota, statement 83
Roberts, Hon. Pat, a Representative in Congress from the State of Kansas, statement 84
Slattery, Hon. Jim, a Representative in Congress from the State of Kansas, statement 84

ISSUES ARISING UNDER THE PAYMENT-IN-KIND PROGRAM

WEDNESDAY, FEBRUARY 23, 1983

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, D.C.

The subcommittee met at 10:20 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Fortney H. (Pete) Stark (chairman of the subcommittee) presiding.

Chairman STARK. The subcommittee meets today to receive testimony on H.R. 1296, introduced by our colleague Tom Harkin and others, to consider issues arising under the payment-in-kind (PIK) program. The administration has adopted a payment-in-kind program under which farmers are paid with commodities in return for diverting from production portions of their farmland. The subcommittee is not considering the wisdom or the merit of the PIK program, but rather will address itself only to the numerous tax issues which the program raises.

Among these are the timing of income from PIK payments; the effect of PIK payments on various estate tax provisions; and the appropriate tax treatment of cooperatives which market PIK commodities.

I would ask witnesses to summarize their testimony and to limit their testimony to 5 minutes. Your entire testimony will appear in the record.

At this point I would ask that, without objection, the press release announcing this hearing be made a part of the record. I would also like to include as part of the record the Treasury Department's press release announcing the payment-in-kind program and the bill, H.R. 1296, as introduced.

[The press releases and bill follow:]

[Press release of Wednesday, Feb. 16, 1983]

HON. FORTNEY H. (PETE) STARK, CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, ANNOUNCES A HEARING ON H.R. 1296, LEGISLATION RELATING TO THE PAYMENT IN KIND PROGRAM

The Honorable Fortney H. (Pete) Stark, (D. Calif.), Chairman of the Subcommittee on Select Revenue Measures, Committee on Ways and Means, today announced a hearing on H.R. 1296 (Messrs. Harkin, Foley, Bedell, Stenholm, Durbin, English, Volkmer, Daschle, Anthony, Hance, Smith of Iowa, Dorgan, Dingell, Glickman, Hightower, Jones of Tenn., Slattery, Penny, Huckaby, Williams of Mont., Wolpe, Dan Crane of Ill., Sabo, Tallon, McHugh, Goodling, Coelho, Evans of Ill., Wyden, Ford of Tenn., Thomas of Ga., Watkins, Hatcher, Brooks, Sunia, Ottinger, Dowdy, Oberstar, Skelton, Simon, Kindness, Roemer, Olin, Staggers, Sam Hall of Texas, and

Pickle) and related issues arising under the Payment in Kind (PIK) program. H.R. 1296 would modify certain tax consequences to farmers who participate in the PIK program. The hearing will be held on Wednesday, February 23, 1983, in the Committee's main hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m. Testimony will be received from Members of Congress, representatives of the Administration, and public witnesses who have requested to be heard.

Chairman Stark stated in announcing the hearing, "The Subcommittee, at the request of Chairman Rostenkowski, is acting quickly as part of an overall Congressional effort to afford farmer taxpayers some guidance before the March 11, 1983 deadline for enrolling in the PIK program."

BACKGROUND

The Administration announced its PIK program for farmers on January 11, 1983. Under the PIK program, farmers who agree not to plant a portion of their land will be paid with government surplus commodities. The Treasury Department has indicated that under present law, a farmer who receives payments-in-kind of commodities is required to include in gross income the fair market value of the commodities when they are made available to the farmer. In addition, the estates of farmers who participate in the PIK program may be ineligible for certain special estate tax rules relating to installment payment of estate taxes and special valuation of farmland. Finally, the PIK program presents issues related to the tax treatment of cooperatives and quarterly payment of income tax.

H.R. 1296 would allow any taxpayer to elect to treat for income tax purposes, any crop received under certain Federal programs for removing land from agricultural production, as produced by the taxpayer. If the taxpayer elects to defer recognition under the bill, the farmer typically will realize income only upon sale of the commodities. The bill would also allow any taxpayer to elect to defer income on any cancellation under such a program of any price support loan. Finally, the bill would provide that participation in the PIK program will not disqualify the taxpayer for current use valuation of farmland under section 2032A of the Internal Revenue Code.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler ((202) 225-3627) no later than noon, Tuesday, February 22, 1983, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This procedure will afford more time for members to question witnesses. In order to expedite the hearing, witnesses may be grouped as panelists with strict time limitations for each panelist.

Requests to be heard must contain the following information:

1. The name, full address, and capacity in which the witness will appear (as well as a telephone number where he or his designated representative may be reached);
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of comments and recommendations. The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the written record of the hearing.

In order to assure the most productive use of the limited amount of time available to question witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 50 copies of their prepared statement to the full Committee office, room 1102 Longworth House Office Building, before the hearing begins.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

For those who wish to file a written statement for the printed record of the hearing, five copies are required and may be submitted to the Committee office by the close of business Friday, February 25, 1983. An additional supply of statements for

the printed record may be furnished for distribution to the press and public if supplied to the Committee office before the hearing.

[Treasury News, for immediate release Monday, Feb. 7, 1983]

Tax Status of New Farm Program

The Treasury Department announced today that it will support legislation to avoid any adverse tax consequences to farmers who participate in the Payment in Kind (PIK) program. This legislation will treat farmers who receive commodities for diverting acreage from agricultural use under the PIK program as if they had grown the commodities themselves. Under current law, the farmer would realize gross income in the amount of the fair market value of the commodities received under the PIK program at the time they are made available to the farmer. The farmer would take a tax basis in the commodities equal to the amount included in income.

Under the legislation, which the Administration supports, the commodities received by the farmer will be excluded from gross income and will have a zero basis for income tax purposes. Thus, the farmer will realize income only at the time he sells the commodities. Further, for purposes of the special farm estate tax valuation rules, the farmer will be treated as if he had actually produced the commodities on the acreage diverted from agricultural use under the PIK program.

Agriculture Department officials said the legislation is needed for an effective PIK program. The deadline for farmers to sign up for the program is March 11. Congress will be asked to act quickly on the legislation so that farmers are aware of the tax status prior to the sign-up deadline.

I

98TH CONGRESS
1ST SESSION

H. R. 1296

To amend the Internal Revenue Code of 1954 to allow any taxpayer to elect to treat for income tax purposes any crop received under a Federal program for removing land from agricultural production as produced by the taxpayer, to allow any taxpayer to elect to defer income on any cancellation under such a program of any price support loan, and to provide that participation in such a program shall not disqualify the taxpayer for the special use valuation of farm real property under section 2032A of such Code.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 7, 1983

Mr. HARKIN (for himself, Mr. FOLEY, Mr. BEDELL, Mr. STENHOLM, Mr. DURBIN, Mr. ENGLISH, Mr. VOLKMER, Mr. DASCHLE, Mr. ANTHONY, Mr. HANCE, and Mr. SMITH of Iowa) introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1954 to allow any taxpayer to elect to treat for income tax purposes any crop received under a Federal program for removing land from agricultural production as produced by the taxpayer, to allow any taxpayer to elect to defer income on any cancellation under such a program of any price support loan, and to provide that participation in such a program shall not disqualify the taxpayer for the special use valuation of farm real property under section 2032A of such Code.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

al farmland removal program of any qualified price support loan, the taxpayer may elect, in lieu of including such amount in income for such year, to include in each taxable year such year's proportionate share of the income from such cancellation.

"(B) YEAR'S PROPORTIONATE SHARE OF INCOME.—For purposes of subparagraph (A), a year's proportionate share of income from cancellation of a loan is an amount which bears the same ratio to the total income from the cancellation of such loan as the amount of the agricultural commodity which secured such loan and which is disposed of (or consumed) during such year bears to the total amount of the agricultural commodity which secured such loan.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) QUALIFIED FEDERAL FARMLAND REMOVAL PROGRAM.—The term 'qualified Federal farmland removal program' means any Federal program for removing land from agricultural production.

"(B) QUALIFIED PRICE SUPPORT LOAN.—The term 'qualified price support loan' means any

SECTION 1. ELECTION TO TREAT CROP AS PRODUCED BY THE TAXPAYER; ELECTION TO DEFER INCOME ON CANCELLATION OF PRICE SUPPORT LOANS MADE BY COMMODITY CREDIT CORPORATION.

(a) IN GENERAL.—Section 451 of the Internal Revenue Code of 1954 (relating to general rule for taxable year of inclusion) is amended by adding at the end thereof the following new subsection:

"(f) PAYMENTS IN KIND, AND LOAN CANCELLATIONS, FOR REMOVING LAND FROM AGRICULTURAL PRODUCTION.—

"(1) PAYMENTS IN KIND.—If any amount would (but for this subsection) be includible in the gross income of the taxpayer for the taxable year by reason of the receipt of any agricultural commodity under a qualified Federal farmland removal program, the taxpayer may elect, in lieu of including such amount in income at the time of such receipt, to treat such commodity as if it were produced by the taxpayer, except that the unadjusted basis of such commodity in the hands of the taxpayer shall be zero.

"(2) CANCELLATION OF LOAN.—

"(A) IN GENERAL.—If any amount would (but for this subsection) be includible in the gross income of the taxpayer for the taxable year by reason of the cancellation under a qualified Feder-

loan made under the Agricultural Act of 1949 to support the price of any agricultural commodity.

"(C) AGRICULTURAL COMMODITY.—The term 'agricultural commodity' includes any interest therein.

"(4) ELECTIONS.—Any election under this subsection—

"(A) may be made separately with respect to each receipt of a commodity and each loan cancelled, and

"(B) shall be made at such time and in such manner as the Secretary may prescribe by regulations."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years ending after December 31, 1982.

SEC. 2. COORDINATION WITH ESTATE TAX TREATMENT OF PROPERTY USED AS A FARM FOR FARMING PURPOSES.

(a) IN GENERAL.—Subsection (e) of section 2032A of the Internal Revenue Code of 1954 (relating to valuation of certain farm, etc., real property) is amended by adding at the end thereof the following new paragraph:

"(15) PAYMENTS IN KIND, AND LOAN CANCELLATIONS, UNDER QUALIFIED FEDERAL FARMLAND

REMOVAL PROGRAMS.—Nothing in this section shall be construed to prevent—

"(A) property from being treated as used as a farm for farming purposes, and

"(B) any individual from being treated as materially participating in the operation of the farm with respect to any property,

for any period merely because during such period, in lieu of producing a crop, such property was removed from production pursuant to a qualified Federal farmland removal program (within the meaning of section 451(f)(3)(A))."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to periods after December 31, 1982.

○

Chairman STARK. Mr. Duncan?

Mr. DUNCAN. Mr. Chairman, I would like to welcome all of you here today as we begin this hearing on a matter which is of great importance to the farming industry of this country.

The payment-in-kind program announced by President Reagan on January 11, 1983, offers farmers a new form of payment for acreage reduction in certain commodities. The U.S. Department of Agriculture will use its existing commodity surplus to pay farmers to reduce their production in 1983. Once received by the farmer, the commodity may be used as the farmer would himself.

The commodities involved are wheat, corn, sorghum, and upland cotton and rice. The Federal Government currently maintains excess amounts of each of the program's commodities in warehouses across the country on which it is paying costly storage fees. A clear economic benefit to the Federal Government will result from reduction of these storage costs.

This PIK program presents a number of tax issues, resolution of which may very well determine the success of the program. It is my hope that these hearings will produce legislation which will meet as nearly as possible the tax related concerns of farmers entering the program.

It is in this spirit that I hope we will be discussing this program today. The program is the centerpiece of the administration's agriculture policy. It is my hope that the members of this subcommittee will work together in recognition of the importance of this program to the Government whose surplus commodities are being used and the farmer who will market these commodities.

We must remember that whatever we decide, we will be affecting an industry already facing economic hardship. We must not place undue burdens on the farmers electing to participate in this program. The members of this committee are looking forward to your comments today so that we may insure against such inequitable results.

Thank you.

Chairman STARK. Any other statements?

If not, we can proceed.

Our first witness is the Honorable John Chapoton, Assistant Secretary for Tax Policy. Buck, you may proceed in any manner you wish.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. Thank you, Mr. Chairman. It is our pleasure to be here today.

I do have a rather lengthy statement, and I will attempt to summarize it.

The first point we make in the statement is, although we have some technical comments on the bill before the subcommittee as presently drafted, the Department does strongly support legislation which would remove any disincentive in current tax law to farmers' participation in the PIK program.

The PIK program is a land diversion program. The Department of Agriculture will compensate a participating farmer for removing

acreage from active production by giving the farmer a percentage of the amount of the commodity he otherwise could have grown.

The income tax consequences are such that under current law, a farmer would realize gross income from the transaction equal to the fair market value of the commodity received. He would take a tax basis equal to that fair market value in the commodity he receives and he would recognize additional income or have a loss when he disposes of the commodity through a sale of it, depending on whether the amount he received was greater or less than the basis he took at the time he recognized the income on receipt of the commodity. If the commodity is used by the farmer for feed, he would be entitled to deduct his basis in the commodity at the time it is so used.

In the case of farmers who have nonrecourse loans from the Commodity Credit Corporation secured by commodities which they either store on their own premises or in warehouses, the situation is a little more complicated.

The PIK program would be implemented for these farmers in two steps. First, the CCC would purchase the commodity from the farmer for an amount equal to the outstanding loan and thereby discharge his debt. And second, the CCC will then deliver that exact commodity or a warehouse receipt representing the commodity to the farmer as his payment-in-kind under the PIK program.

The income tax consequences in this situation would depend upon whether the farmer has made an election under section 77 of the code to treat the nonrecourse loan from the CCC as a sale for tax purposes when originally made.

If a section 77 election were made, then the loan proceeds are included in the farmer's income in the year of receipt of the loan proceeds, and since that farmer has already recognized the income, then on cancellation of the loan—cancellation of the indebtedness in exchange for the commodity securing the loan—there would be no further tax consequences to the farmer.

The subsequent transfer of the commodity back to the farmer would be subject to the same tax treatment as I have described above; that is, the fair market value of the commodity would be taxable to him.

In the case of a farmer who has not made a section 77 election, the loan, when it is made, is treated as a loan rather than a sale, and therefore the PIK transaction would be treated as a sale of the commodity for an amount equal to the outstanding debt which is discharged.

And then the second step in the transaction, the delivery of the commodity to the farmer, would also be taxable in the amount of the fair market value of the commodity the farmer receives.

There are also potential estate tax consequences under the PIK program. Under section 2032A of the code, real property which is used as a family farm and which passes to or is acquired by a qualified heir may be included in the decedent's estate at its current use value rather than its full fair market value.

Two principal requirements must exist for this estate tax benefit to be granted. First, the property must have been owned by the decedent or a member of his family and must have been used as a farm for farming purposes in 5 out of the 8 years preceding his

death. And second, there must have been material participation in the operation of the farm by the decedent or a member of his family in 5 out of the preceding 8 years.

Another estate tax provision relevant to the farmers in this case is section 6166 of the code which allows deferred payment of estate tax where certain conditions are met. One of the conditions is that 6166 is limited to cases where there is an active trade or business.

A question may arise whether property on which a cash crop is not being grown as a result of participation in the PIK program or some other acreage reduction program is being used as a farm for farming purposes, and similar questions could arise whether the material participation requirement is met and whether the active trade or business test is met.

None of these questions is specifically addressed in the present statute and there have been no regulations or rulings published that address these exact facts.

In the Department's view, however, the dedication of land to an acreage reduction program sponsored by the Department of Agriculture generally should not prevent satisfaction of the requirements of section 2032A or section 6166 under present law, particularly where a portion of the farm remains in active production. As we specify in our statement, if the farmer removes his whole farm from the active production, no portion of the farm being used in active production, then present law is less clear because there might be some difficulty in meeting the material participation in farming requirement.

H.R. 1296 would solve, would attempt to solve, the income tax problem I have discussed by amending section 451 of the code. Basically the taxpayer could elect to exclude the value of the commodities received under the PIK program from income in the year of the receipt and to treat the commodities as if they were grown by him. Any commodities with respect to which the election is made would have a zero basis, and thus, the farmer would realize income only at the time he sells the commodity, usually in a later year, or if he used the commodities for livestock feed, at the time he sells the livestock to which the commodities were fed.

The bill would provide the taxpayers who otherwise have to recognize income by reason of a cancellation of a CCC loan may elect to defer the income recognition as well.

The taxpayer may elect under H.R. 1296 separately with respect to each PIK payment received and each loan canceled under the CCC arrangement.

H.R. 1296 also deals with the estate tax provision. It says basically that under 2032A the fact that property is removed from production pursuant to a qualified Federal farmland removal program, which would include the PIK program, shall not prevent the property from being treated as used as a farm for farming purposes, or prevent an individual from being considered a material participant in the operation of the farm prior to his death.

Mr. Chairman, we note in our analysis of this matter that many farmers who would participate or will participate in the PIK program will have sold crops in the current taxable year which were harvested in a prior year. Thus, under current law, they will often have, in effect, income from two crops, the income from the prior

year's crop plus in that same taxable year the income received on the commodity under the PIK program when it is made available to them in the current year.

In addition, farmers participating in the PIK program will be under pressure to sell commodities to obtain cash to pay their income tax liabilities arising from this actual or constructive receipt of the PIK payments, and those sales may have to be made in a market flooded with commodities being sold by other farmers facing the same tax liquidity problems.

These tax motivated sales may cause farm commodity market problems of the type the PIK program is indeed designed to reduce. And we are concerned that the potential tax and market problems could discourage farmers from participating in the PIK program, thus frustrating Federal agricultural policy.

For these reasons, the Treasury Department supports the changes in the current law which adopt the general position underlying H.R. 1296. Because PIK payments, in effect, are replacements, the tax law should treat farmers who receive commodities under the program as if they had grown the commodities themselves. Thus, the farmers would recognize the income only in the year they actually sell or otherwise dispose of the commodities in question.

We have several technical comments that I will not go into now on H.R. 1296. We do not think it ought to be done under section 451 of the code but ought to be done separately.

We think in the CCC loan context, farmers who have not made a section 77 election should not be entitled to avoid income on the discharge of their debt but only avoid income on the amount of the PIK payment received. Because they have the cash available to pay the tax, tax liability should arise on the discharge of the CCC debt.

Third, we think the tax treatment ought to be mandatory rather than elective.

We also support the provisions of H.R. 1296 relating to section 2032A of the code. As I mentioned, we think the law probably is favorable on these points already, but some provision making that crystal clear would assure farmers that participation in the program will not adversely affect their eligibility for special use evaluation.

There are other tax consequences potentially arising from participation in the PIK program that we outline in our testimony. We believe that farmers, as I have stated, who participate in the program should be treated as if they had grown the commodities received for all purposes, and thus we think, while it can usually be reached under current law, that the legislation should address some of these ancillary issues to the extent that current law needs to be clarified, and those are specified in my testimony.

So Mr. Chairman, just in summary, we do support the policy thrust of H.R. 1296, and we hope the subcommittee will act rapidly on it because it is important that we get the word out that the participation in the program will not have adverse tax consequences.

I would be happy to answer any questions you might have, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY, TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittee: I am pleased to have the opportunity to present the views of the Treasury Department on H.R. 1296, which deals with the tax treatment of farmers who participate in the Administration's Payment-in-Kind (PIK) program. Although we have some technical comments on the bill as currently drafted, the Treasury Department strongly supports legislation which would remove any disincentives in current tax law to farmers' participation in the PIK program.

BACKGROUND

The PIK program is a land diversion program designed to reduce the amount of certain agricultural commodities in the marketplace, thereby raising the prices of such commodities. Under the PIK program, the Department of Agriculture will compensate a participating farmer for removing acreage from active production by giving the farmer a percentage of the amount of the commodity he otherwise could have grown. The commodity is to be available to the farmer at the time of normal harvest, although the government will pay storage costs for up to five additional months.

Income tax consequences

Under current income tax law, a farmer would realize gross income from this transaction equal to the amount of the fair market value of the commodity received at the time the commodity is made available to him. The farmer would take a tax basis in the commodity equal to the amount included in income. He would recognize additional income (or loss) from the sale of the commodity if the amount realized from such sale exceeds (or is less than) the amount already included in income. Further, the farmer would be entitled to deduct his basis in the commodity to the extent it is used for feed.

The current law income tax treatment of the transaction involved in the PIK program is more complicated in the case of farmers who have nonrecourse loans outstanding from the Commodity Credit Corporation (CCC) secured by commodities which they either store on their own premises or in warehouses. The Department of Agriculture proposes to implement the PIK program for these farmers in two steps, as follows:

(1) the CCC will purchase the commodity from the farmer for an amount equal to the outstanding loan which is secured by the commodity, and the loan will thereby be discharged; and

(2) the CCC will then deliver that exact commodity or, in the case of farmers whose commodities are stored in warehouses, the warehouse receipt representing the commodity, to the farmer as his payment-in-kind under the PIK program.

The income tax consequences to a farmer in these circumstances would depend upon whether the farmer has made an election under section 77 of the Internal Revenue Code to treat the nonrecourse loan from the CCC as a sale for tax purposes. If the farmer makes a section 77 election, the loan proceeds are included in the farmer's income in the year of receipt. Since a farmer who has made a section 77 election has already been taxed on the proceeds of his CCC loan, the cancellation of that loan in exchange for the commodity securing the loan would have no further tax consequences to the farmer. The subsequent transfer of the commodity back to the farmer would be subject to the same tax treatment as described above; that is, the farmer would have gross income equal to the fair market value of the commodity when it is made available to him and would take a basis in the commodity equal to that value.

In the case of farmers who do not make a section election, the CCC loan, when made, is treated as a loan rather than a sale. Therefore, the PIK transaction would be treated as a sale of the commodity for an amount equal to the outstanding debt which the commodity secured, followed by receipt of the commodity as a PIK payment. The result would be that the farmer would be taxed first on the amount of the debt which was discharged in the sale transaction and second on the amount of the fair market value of the commodity received in the PIK transaction. However, as discussed above, the farmer would take a basis in the commodity received equal to its value.

Estate tax consequences

Under section 2032A of the Internal Revenue Code, if certain requirements are met, real property which is used as a family farm and which passes to or is acquired

by a qualified heir may be included in a decedent's estate at its current use value, rather then its full fair market value. Among the requirements which must be satisfied are: (1) the property must have been owned by the decedent or a member of his family and used "as a farm for farming purposes" on the date of the decedent's death and for periods aggregating five years or more during the eight-year period ending with the decedent's death; and (2) there must have been "material participation" in the operation of the farm by the decedent or a member of his family for periods aggregating five years or more out of the eight-year period ending on the date of the decedent's death.

Section 2032A also provides that the estate tax benefit of special use valuation generally is recaptured if the qualified heir disposes of the property to a nonfamily member or ceases to use the property "as a farm for farming purposes" within 10 years after the decedent's death and before the qualified heir's death. With certain exceptions, the qualified heir ceases to use the property for the qualified farming use in the farm operation for periods aggregating more than three years during any eight-year period ending after the decedent's death and before the qualified heir's death.

Another estate tax provision relevant to many farmers participating in the PIK program is section 6166 of the Code, which allows deferred payment of estate tax attributable to qualifying closely held business interests owned by decedents. The benefits of section 6166 are limited to interests in active trades or businesses.

A question may arise whether property on which a cash crop is not being grown as a result of participation in the PIK program, or in some other acreage-reduction program sponsored by the Department of Agriculture, is nevertheless being used "as a farm for farming purposes" within the meaning of section 2032A. Similar questions may be posed as to whether there has been the requisite "material participation" for purposes of section 2032A and whether the property is part of an active trade or business qualifying for estate tax deferral under section 6166.

None of these estate tax questions is specifically addressed in the present statute, and neither the regulations nor the published rulings have addressed these exact issues. It is Treasury's view, however, that the dedication of land to an acreage-reduction program sponsored by the Department of Agriculture generally should not prevent satisfaction of the requirements of section 2032A or section 6166 under present law, particularly where a portion of the farm remains in active production. In such as case, there would still be property used as a farm for farming purposes and material participation in its operation. Moreover, nothing in section 2032A or section 6166 requires that its tests be applied on an acre-by-acre basis. The fact that a portion of a farm is temporarily left fallow of covered with a conservation crop pursuant to an agreement with the Department of Agriculture does not mean that such portion is no longer a part of the farm or that it is not being used for farming purposes. In fact, fields are often temporarily removed from active production for soil conservation or other farming reasons having nothing to do with Federal acreage-reduction programs.

If a farmer removes his whole farm from active production, however, the result is somewhat less clear. In particular, if no portion of the farm is being used for farming purposes in the traditional sense, it is unclear whether there can be the required material participation in a farming operation. Also, it may be argued that if an entire farm is withdrawn from production, it has ceased to be used as a farm during that period.

DESCRIPTION OF H.R. 1296

Income tax provisions

H.R. 1296 would amend section 451 of the Code, which relates to the taxable year income is to be taken into account for tax purposes, by providing that a taxpayer under the PIK program from income in the year of receipt and to treat the commodities as if they were grown by him. Any commodities with respect to which such an election is made would have a zero basis for tax purposes. Thus, the farmer would realize income only at the time he sells the commodities or, if he uses the commodities for livestock feed, at the time he sells the livestock to which the commodities were fed.

Further, the bill would provide that taxpayers who would otherwise have to recognize income by reason of the cancellation of a CCC loan may elect to defer such income recognition. Under this election, a portion of the total proceeds from the cancelled loan would be included in income in the year the loan is cancelled and in succeeding taxable years in an amount equal to the proportion of the total commodity which secured the loan that is sold or consumed in each such taxable year.

Taxpayers may make either or both of the elections provided by H.R. 1296 separately with respect to each PIK payment received and each loan cancelled under the program.

Estate tax provisions

H.R. 1296 also would amend section 2032A to provide that the fact that property is removed from production pursuant to a "qualified Federal farmland removal program," shall not prevent (i) such property from being treated as used as a farm for farming purposes nor (ii) any individual from materially participating in the operation of the farm with respect to any property. A "qualified Federal farmland removal program" is any Federal program for removing land from agricultural production, including (but not limited to) the PIK program.

H.R. 1296 does not contain any provision which specifically addresses the effect of the PIK program on section 6166.

DISCUSSION

Timing of income recognition

Many farmers participating in the PIK program will have sold crops in the current taxable year which were harvested in a prior taxable year. Current law may impose a hardship on these taxpayers because they will have, in effect, income from two crops (the income from the prior year's crop that is sold, plus the income from the PIK payment) in the same taxable year. In addition, farmers participating in the PIK program will be under pressure to sell commodities to obtain cash to pay their income tax liabilities arising from the actual or constructive receipt of the PIK payments; and those sales may have to be made in a market flooded with commodities being sold by other farmers facing the same tax liquidity problem. These tax-motivated sales may cause farm commodity market problems of the type that the PIK program is designed to reduce. The potential tax and market problems also may discourage farmers from participating in the PIK program, thus frustrating Federal agricultural policy.

In view of these problems, the Treasury Department strongly supports changes in the current law which adopt the general policy position underlying H.R. 1296. Because PIK payments, in effect, are replacements for the commodities which farmers could have been expected to produce from the normal use of land devoted to the program, the tax law should treat farmers who receive commodities under the program as if they had grown the commodities themselves. Under this approach, farmers would recognize income only in the year they actually sell or otherwise dispose of the commodities in question. However, as I indicated earlier, we do have some technical comments on the bill as currently drafted.

First, we do not believe that the bill should be drafted as an amendment to section 451 of the Code. Section 451 relates to the timing of the recognition of income depending upon the taxpayer's method of accounting. Under either the cash or accrual method of accounting, a PIK payment would be recognized for tax purposes in the year the farmer receives or has a right to receive the payment. The issue is not one of timing but one of income inclusion. We believe that the bill should be drafted to provide an exclusion from gross income for commodities received under the PIK program and, further, to provide that those commodities will have a zero basis for income tax purposes.

Second, the bill would permit farmers who have not made a section 77 election to take any amounts realized from the CCC loans into income as the commodities are sold or consumed, rather than at the time the loans are discharged. We seriously question whether such relief is warranted. In such cases, the farmers already have received the cash necessary to pay any tax resulting from the income realized from the loan proceeds. Further, this provision of the bill would provide farmers who have not made a section 77 election with a significant advantage over those farmers who have made an election and have already paid tax on the loan proceeds received.

Third, we believe that the income tax rules provided by the bill should be mandatory rather than elective. Mandatory rules would be fully consistent with the objective of treating farmers who participate in and receive commodities under the PIK program as if they had grown the commodities themselves. We acknowledge that some taxpayers may have made the decision to enter into contracts with the Department of Agriculture based on the tax consequences under current law. If such taxpayers want taxable income during the current taxable year, however, they generally can achieve that result by selling the commodities received pursuant to the program in the current taxable year.

Special use valuation

Treasury generally supports the provisions of H.R. 1296 relating to section 2032A of the Code. To the extent that present law is unclear, these provisions will assure farmers that participation in the PIK program will not adversely affect their eligibility for special use valuation. Moreover, the provisions in H.R. 1296 dealing with section 2032A are consistent with the general approach of treating farmers as if they had grown the PIK commodities on the land they dedicate to the program.

Other tax consequences

The questions whether PIK payments should be treated as if farmers had grown the commodities themselves and whether farmers who divert some or all of their acreage under the PIK program should be considered as engaged in the trade or business of farming are questions that have ramifications for a number of other provisions of the Code. For instance, section 447 provides special accounting rules for corporations engaged in the trade or business of farming. Section 175 provides special treatment for soil and water conservation expenditures for taxpayers engaged in farming. Tax exempt farmers' cooperatives could lose their exemptions if the commodities received by their members and assigned to the cooperatives were not treated as produced by the members. Moreover, a determination of the self-employment income of a farmer who diverts acreage pursuant to the PIK program also depends on whether the farmer is deemed to participate materially in the production of farming commodities or the management of that production. Finally, a decedent's eligibility for estate tax deferral under section 6166 could be threatened if property involved in the PIK program is not treated as being used in an active trade or business. H.R. 1296 does not deal with any of these ancillary issues.

We believe that farmers who receive PIK payments should be treated as if they had grown the commodities received for all purposes of the Code and that participation in a Department of Agriculture program should be treated as a farming activity. We believe this result can be reached in most cases under current law. However, the legislation should address these ancillary issues to the extent that current law needs to be clarified to ensure appropriate results.

CONCLUSION

In conclusion, I would like to reiterate our strong support of legislation that will remove any impediment to the successful operation of the PIK program which current tax law may create. While I have noted some technical comments on the bill as currently drafted, I am confident that we can work out a satisfactory solution to these problems with the Subcommittee.

I would be happy to answer your questions.

Chairman STARK. Thank you, Mr. Secretary.

Mr. Flippo, would you like to inquire?

Mr. FLIPPO. Thank you, Mr. Chairman.

I have a question about how you would value the payment at the time that it is received by the farmer.

Could you elaborate on that?

Mr. CHAPOTON. Mr. Flippo, the valuation is always a problem when you receive income that is other than money. The law states that it is fair market value, which is defined in the regulations under the code as what a willing buyer would pay to a willing seller, neither being under compulsion to buy nor sell.

Beyond that, I do not think I could enlighten the subject any other than to say that normal valuation methods would have to be used. It would be what the commodity could be sold for in the market if one chose to sell it at that time.

Mr. FLIPPO. Do you anticipate that that will be a major problem in the actual execution of the program and in the payment of the taxes?

Mr. CHAPOTON. We really have not addressed that problem in any detail because we think the problem should be avoided. But it would be a problem, yes. If you have a significant number of farm-

ers that have to go through a valuation to determine what their income is, I could see a problem arising. But I am personally not familiar with how set, how established values are of the various commodities.

Mr. FLIPPO. Your suggestion of how to avoid it would be

Mr. CHAPOTON. My suggestion of how to avoid it is not to treat the commodity as income when it is received or made available to the farmer, give him a zero basis in it, so he will pay tax when he disposes of the commodity. Then he will have the cash, and so you do not have the valuation problem.

Mr. FLIPPO. Could you give us any kind of information about the potential amounts involved in the program?

For instance, can we get information on a county-by-county basis of who might participate in this program, what the magnitude of the participation may be, or what the total cost to the Government may be?

Mr. CHAPOTON. Mr. Flippo, I will have to defer that question to the Department of Agriculture. Secretary Lyng will testify on that.

Mr. FLIPPO. Thank you.

Thank you, Mr. Chairman.

Chairman STARK. Mr. Duncan.

Mr. DUNCAN. Mr. Chapoton, how will the farmers be notified? Not all farmers have accountants and lawyers and staff people to notify them of the program. The deadline is March 11.

How will they be notified other than through the news media?

Mr. CHAPOTON. If you mean the program itself, I think the Department of Agriculture has spent a great deal of effort in notifying farmers, and they can speak to that much better than I.

On the potential tax problem, I understand there has been some. We, of course, have had a press release where we stated that we would support bills that have been introduced to remove any tax problem. I understand that has received a good deal of attention. But it probably bears a good deal more announcement, more publicity, particularly if this subcommittee acts favorably on such legislation.

Mr. DUNCAN. I will address some of that with the Department of Agriculture when they testify.

Thank you.

Chairman STARK. Mr. Dorgan?

Mr. DORGAN. Thank you.

Mr. Chapoton, thank you for your testimony. We certainly agree on the conclusions of the testimony. I believe that the IRS erred in its tax ruling, but then, it has the right to be wrong.

Mr. CHAPOTON. Mr. Dorgan, if I could comment on that, IRS has not actually issued a ruling. It was discussed with the Department of Agriculture early on. With all deference, we, and I think even some tax experts in the agricultural community, agreed that without some legislation, it was almost unavoidable, that when one receives a valuable commodity, one has taxable income at that time.

So we thought the IRS really did not have to issue a ruling, that we did need legislation. We just concentrated our efforts in that direction.

Mr. DORGAN. I guess I was referring to the interpretation that was publicized by the IRS of how the receipt of the PIK certificate

was going to be viewed for tax purposes, an interpretation that I do not agree with. In any event, both of us agree that we must have some legislation to set it right and to give the farmer the opportunity to treat the PIK certificate just as if the farmer had grown the grain, for tax purposes. We agree on that point. I want to help you achieve that goal legislatively.

Tell me if you can, historically, how has income from farming been treated for tax purposes? The PIK certificate represents a claim for certain quantities of grain in exchange for the farmer agreeing not to produce certain quantities of grain during the current year.

Have farmers historically, since the beginning of the income tax, been given the opportunity to use cash accounting and therefore report for income tax purposes the proceeds when the grain is sold?

Mr. CHAPOTON. That is correct.

Mr. DORGAN. That has historically been true over the decades?

Mr. CHAPOTON. That has historically been true, yes, sir.

Mr. DORGAN. So that treating the PIK certificate as reportable for tax purposes when the certificate is received would be inconsistent, generally, with the treatment of how the farmer has had to report their crop for tax purposes?

Mr. CHAPOTON. It would, but the result would not be inconsistent. In answer to your first question, farmers generally have been entitled to use the cash rather than the accrual method of a accounting when most taxpayers who have inventories must use the accrual method. But under the cash method, you don't have to receive cash to have income. So it is, to that extent, a misnomer. If you receive value, then when you receive it or are entitled to receive it, you have to pay taxes.

Mr. DORGAN. I understand, but what I am saying is that if the law is not changed, the current interpretation of how the law applies to the PIK certificate would be inconsistent with the way the farmer has traditionally treated the crop that he or she is growing.

Mr. CHAPOTON. That is absolutely correct.

Mr. DORGAN. If the law is not changed, have you had a chance to visit with the representatives from the Agriculture Department to determine what would the effects be on the PIK program?

Mr. CHAPOTON. We have discussed that. They can answer it. They are more in touch with the farmers and could answer that more fully than I. But there is serious concern that it would adversely affect the participation in the PIK program.

Mr. DORGAN. Is there a windfall in the legislation for any group of farmers, be they large or small, by giving the farmer the opportunity to treat their PIK certificate just as if they had grown the grain, for tax purposes?

Mr. CHAPOTON. No, Mr. Dorgan. We think there is no windfall. That is a question we have looked at rather closely, as we always do. The Treasury Department looks at items such as deferring income and deferring tax rather closely. In this case we saw no windfall, no concern whatsoever.

Mr. DORGAN. Mr. Chapoton, again let me say that I think that this is a situation we have to correct to give the PIK program the best opportunity possible to work on behalf of the American farmers. It is something that we have to correct quickly.

I am hoping that the other members of the subcommittee share that sentiment.

Thank you very much for your testimony.

Mr. CHAPOTON. Thank you.

Chairman STARK. Ms. Kennelly?

Ms. KENNELLY. Thank you, Mr. Chapoton.

Do you think that it has been established, that if you extend the special PIK protection to cash payments, that we can assume that farmers will be better off than they are today under the old system?

Mr. CHAPOTON. Are you contrasting economically, aside from the tax benefits?

Again, let me defer. That goes to the soundness of the PIK program. The Department of Agriculture could address that a lot better than I, how they arrived at the percentage of the payment-in-kind and that type of arrangement.

From the tax standpoint, which is what I am limiting myself to, they will be no better off. I think as, Mr. Dorgan points out, they should be in exactly the same position as if they had grown the crop.

Ms. KENNELLY. All right.

Let's go back to just tax policy.

Does this proposal go against established tax policy?

Mr. CHAPOTON. It changes the law that would otherwise be applicable to this case, but we think it is consistent, because the tax policy or tax law is that the receipt of cash or property is income to a cash basis taxpayer when it is received or made available to him.

But that would be inconsistent with the normal treatment of a farmer who is taxed when he sells his crop and has the cash. Therefore, a change in the law we think is consistent with sound tax policy here.

Ms. KENNELLY. So it is consistent; it is not a reaction to an emergency?

Mr. CHAPOTON. That is correct. It is consistent rather than a reaction to an emergency; yes, ma'am.

Ms. KENNELLY. Thank you, sir.

Chairman STARK. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Secretary, the estate tax consequence; do I understand correctly that in your opinion participation in the PIK program would be considered farming?

Mr. CHAPOTON. Yes. We think that it should be treated as farming for all purposes of the Code; yes, sir.

Mr. SCHULZE. Has anybody looked into the ramifications—I know several States have laws which were put into effect to protect the small family farm of what would happen in relationship to the State laws if an individual participated in the PIK program? Or will they have to make changes, some of them have to make changes?

Mr. CHAPOTON. Mr. Schulze, that is a very good question. My office has has not looked into that question, to my knowledge. We have not. The question has not been raised. But I frankly think that is something we should look at.

Mr. SCHULZE. If I am not mistaken, there are State programs that parallel——

Mr. CHAPOTON. I would think there usually are. Of course, that would take State action. There is not much we could do about it other than inform the States. But it is certainly something we should do.

Mr. SCHULZE. That is the point I was leading up to. I would appreciate it, if you do get that information, at least as it relates to Pennsylvania, I would appreciate you sending it to me and I will see that they get it.

Mr. CHAPOTON. I would be happy to.

Mr. SCHULZE. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman STARK. Mr. Jenkins?

Mr. JENKINS. Thank you, Mr. Chairman.

Mr. Secretary, thank you for your testimony.

I do not know that I fully understand all of the details of how this would be handled from a tax policy standpoint. I am unclear as to what the basis would be, first of all.

Assume that a farmer received $100,000 in grain and sold it that day. What is his tax situation?

Mr. CHAPOTON. Under present law, first, he would technically realize taxable income on the receipt in the morning, if you will, and the sale in the afternoon, assuming and he would have a basis of $100,000. The value, clearly in that case, would be $100,000. He would have a basis of $100,000. Then the sale that afternoon would be at his basis, and there would be no gain or loss on the sale.

Mr. JENKINS. So the basis is the value at the time that it is given to the farmer?

Mr. CHAPOTON. That is correct.

Mr. JENKINS. Now, would he be entitled to deduct all of the expenses of the farm operation as it would apply against his other farm income?

Mr. CHAPOTON. That is correct. He would be entitled to deduct his normal farming expenses without change.

Mr. JENKINS. One of the real reasons that you are wanting to change existing tax policy on receipt of cash or property is the fact that under normal circumstances the farmer sometimes waits until later to dispose of his property, and we may be forcing that farmer into a situation where he would sell last year's crop now and also have the receipt of these funds to add to that income in this year. Is that correct?

Mr. CHAPOTON. That is correct. It would clearly put a pressure on him to realize income from the second crop, if you will, the crop he has received under the PIK program, because he is going to have tax liability on that crop.

Mr. JENKINS. Under normal circumstances, does the deferment at the time of sale go beyond 12 months?

Mr. CHAPOTON. I understand that it would not go beyond 12 months.

Mr. JENKINS. We would normally be taking care of the problem, if there were a deferment, with some limitation?

Mr. CHAPOTON. Deferment until the next year would normally take care of the situation, correct. I would assume that under this legislation that is what would normally happen.

Mr. JENKINS. Sometimes when we make these changes in tax policy, we do not see the exceptional case.

Let me ask you this. I am trying to visualize areas that might give us some problems. If a person received half a million dollars in payments, decided not to sell the grain or cotton or whatever it may be, and then sold his farm that year but held on to the product because of income situations or whatever, would he still be entitled to defer that income?

Mr. CHAPOTON. Yes, he would. It would be exactly as though he had grown it. So he would pay any gain or loss on the sale of the farm, pay tax on any gain or loss on the sale of the farm, and then the commodity that he retained, whether he received it in the PIK program or had grown it, income would be realized and tax due when he sold that commodity.

Mr. JENKINS. What if he entered into a contract to sell the commodity 2 or 3 years down the road and received considerable cash at the signing of the contract? When would it be taxable?

Mr. CHAPOTON. Normally there would be tax on the cash received. He would probably report under the installment method, and therefore, pay tax. If he did not elect the installment method—and now he is on the installment method unless he elects otherwise—then the entire cash would be taxable to him when received because he would have no basis in the crop sold if it is——

Mr. JENKINS. What do you mean he would have no basis? He would have the basis, would he not, of the value at the time——

Mr. CHAPOTON. I am sorry. I am confusing you somewhat because I was describing it under the bill. Under present law, he would have a basis. If this bill, if legislation were adopted, then on the PIK program he would have a basis and taxable income when he receives the payment, and then he would have that—the value—as his basis. So the later sale would mean he would have no income on the sale of it if he elected out of installment treatment. The fluctuation in the value of the commodity from the date he received it until the date of sale would determine whether he has any tax liability on the sale.

Mr. JENKINS. It would appear to me there would be a great incentive, anyway, to come under the PIK program because, in addition to the cash payment that one could get for the set-aside, you could also expense all expenses of the farm against other income, could you not? That would also tend to give you greater net income?

Mr. CHAPOTON. That is true. Of course, the expenses of growing this crop would not exist. But the other expenses would go on. It would be deductible, that is correct.

Mr. JENKINS. Thank you, Mr. Chairman.

Chairman STARK. Mr. Moore?

Mr. MOORE. Thank you, Mr. Chairman.

Mr. Secretary, you were answering the question of my colleague, from Connecticut, Ms. Kennelly, a moment ago about the difference of trying to make similar tax treatment with farmers under this bill as they are normally treated.

Do most farmers not report their income on a cash basis?

Mr. CHAPOTON. I would say almost all farmers report do. Probably all farmers report on the cash method.

Mr. MOORE. If we give them this——

Mr. CHAPOTON. Mr. Moore, let me except corporations. Large corporations must be on the accrual method, that is correct.

Mr. MOORE. If we tax them at the time of receipt of this warehouse receipt under the PIK program, really, essentially we are differing the treatment of farmers to almost going to an accrual basis.

Mr. CHAPOTON. Well, it is really not equated to the accrual basis. The accrual basis requires capitalization of expenses as they are incurred, but the result will be obviouly an earlier realization of the income. So it would change from year to year the method of taxation of the farmer.

Mr. MOORE. So the bill puts it back on a cash basis, when they actually receive the cash income from the sale of the crop.

Mr. CHAPOTON. I am trying to stay away from the cash, or describing this as a cash basis, because technically cash basis would require it in the earlier year, but as far as consistency with the way he would normally pay tax on that crop, it is consistent with it in that it would be taxable when sold. He realizes income when he receives the cash.

Mr. MOORE. Mr. Secretary, in the staff work-up that we have been given, there are some revenue situations involving this bill.

My understanding is that in fiscal year 1984 you would loose in income tax revenues $476 million which you would pick up in 1985.

Is that simply a wash, we are just delaying the income tax the farmers would pay on the warehouse receipt until they actually sell the crop and pay income tax on the cash receipts from that sale?

Mr. CHAPOTON. That is correct.

Mr. MOORE. There is also an item listed as estate tax, showing the revenue that would be lost in fiscal year 1984 in estate tax receipts.

Would you explain that for the committee?

Mr. CHAPOTON. Mr. Moore, I am not sure I can explain that. We do not agree with that figure. I think there is possibly a disagreement among the staffs here on present law, that is, whether the participation in this program or similar programs would cause the estate tax benefits of section 2032A to be lost.

Our interpretation of present law is that they would not be lost. So therefore, we would not put a revenue figure on this change.

I would also mention as to both figures, and particularly the income tax figure because we have the same figures that you read on income tax, that in the present receipts, in the budget receipts, this program was not in the budget. So there would not be a loss from present receipts but there would be a loss from receipts that would occur if the program occurred and the present tax law were not changed. So it would be an increase in receipts over the present budget estimates, is my understanding.

I want to get into that question more fully, but that is my present understanding of the case.

Mr. MOORE. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Chairman STARK. I would like to go back on how we got from a billion dollar loss, to an increase here. You went through that a little too quickly for me.

Could you run through that one again?

Mr. CHAPOTON. Well, in the budget receipts, before this program was introduced, we have estimated budget receipts from taxes. Let's just stay with the income tax for a minute because we agree with this figure. It would assume that farmers grow their crops, sell their crops under ordinary programs, and therefore, that income from crops grown in 1984—and I am going to generalize here a little bit—would be realized in 1985, and tax liability would be paid.

Chairman STARK. We have to go back a year, though. We are dealing, because of the way they pay taxes, with crops grown in 1982 but on which taxes get deferred until 1983. We actually do not collect the tax until March of 1984.

Mr. CHAPOTON. Correct.

Chairman STARK. So they are already operating, for the most part, on that much of a time lag.

Mr. CHAPOTON. That is correct. Farmers do have that time lag. You are right, I am using the wrong year. I was talking about 1983 tax liability would occur to the farmer in 1984.

Then, if the PIK program goes into effect, as it will, then the crop received would be taxable income without a change in the tax law, and therefore, you would have an increase in receipts over present budget estimates.

But it is correct to state that from that baseline, enactment of this law would reduce receipts.

Chairman STARK. But if we just take the postponement, we still are postponing collection for a year?

Mr. CHAPOTON. Right.

Chairman STARK. This is very similar, if not almost identical, to the bill I struggled to pass for the State of California which would have changed their collection of franchise taxes. I think it was labeled with a $100 million revenue loss which would have been made up the next year.

Mr. CHAPOTON. There is one difference. In that case we were, if you will, counting on the money, even though we supported that principle. We had a little difficulty with giving up the money. In this case, when the budget came out, we really were not counting on the money.

Chairman STARK. We ought to have the farm votes for that bill next time it comes up. Would that not be your guess?

Mr. CHAPOTON. I am not sure the overlap would occur.

Chairman STARK. You did address, in response to Mr. Moore's question, the costs estimate in the joint committee report of $470 million. And there is also a question of some loss from inheritance taxes.

Mr. CHAPOTON. $615 million is what I have.

Chairman STARK. $615 million, which is a permanent loss. So we are talking about a billion in 1984 of which $470 million would be recaptured in 1985.

Do you concur with those estimates?

Mr. CHAPOTON. No, Mr. Chairman.

As I mentioned in response to Mr. Moore's question on the estate tax, I think we just have a disagreement with the staff.

Generally speaking, we would not think any of that loss would occur because we think, under the present rules, that the estate tax benefit exists. Now, that is——

Chairman STARK. So you do not think we need any legislation, then.

Mr. CHAPOTON. No, as we state in our testimony that it would probably be helpful because this confusion has arisen and there might be instances—well, the answer to your question is correct. We do not think you need any change in the 2032A rules.

Chairman STARK. Is that a ruling that you have issued before?

Mr. CHAPOTON. No, we have not ruled on that before.

Chairman STARK. This would be your idea of a new rule to correct the estate tax problem?

Mr. CHAPOTON. Well, when this arose, we examined that question, and that was our conclusion at that time. But the question could arise under present law, and it certainly should be the subject of a ruling at some point.

Chairman STARK. I also want to now explore a little bit, a line of questioning that Ms. Kennelly started, and that is whether or not this is not really a departure from established tax policy.

I just think, for instance, I think that the constructive receipt of income has been a pretty established policy.

Mr. CHAPOTON. And a very important principle in the tax law.

Chairman STARK. Let's just assume for a minute that Mr. Moore and I are partners and I own the land and he does all the work, usually it is the other way around in this committee. He has all the good ideas and I do all the work.

But aside from that, if we get together and I get half the crop and he gets half the crop, does that mean that we just divvy up the warehouse receipts and I do not have to—and I own the real estate but I am not actively farming—take into income my share until such time as I sell the crop; is that correct?

Mr. CHAPOTON. That would be the result under this bill and under what we are supporting, yes, sir.

Chairman STARK. Let's just assume for a minute that I am not so generous with Mr. Moore and he merely runs a combine crew, but he has for a long time been paid a portion of the crop—he gets 10 percent, 1 out of every 10 bushels—and we continue that procedure, and he is operating a combine group but is not really a farmer. He is a labor contractor. I give him, then, 1 out of 10 bushels of a warehouse receipt, and he does not have to report that income until he sells the grain; is that correct?

Mr. CHAPOTON. That is correct. I am not sure your arrangement would stay the same, but if it did, that would be the result under this bill.

Chairman STARK. Well, now to carry that to its horrid conclusion, after so many of us have worked so hard to limit these barter exchanges that come up, where do we stop? If he paints my barn and in the area it has been the practice to provide him a cow or a calf, I instead provide him with 10 bushels of wheat to paint my barn, and I give him the warehouse receipt. Does that mean he as

a painting contractor does not have to take this into income until he sells the wheat?

Mr. DORGAN. Will the chairman yield on that point?

Chairman STARK. Well, I want to get the answer, and then I will yield.

Mr. CHAPOTON. Well, no. The answer is—I see the point you are making Mr. Stark. It would not apply there. In other words, you could not use this commodity as a medium of exchange. The question we are addressing and the question the bill addresses is how the payment by the Government to an individual farmer for agreeing not to utilize his land to grow crops is to be treated.

Now, if that payment were purely for services, I do not think that result would follow, and indeed, I may have been wrong in my answer to your question about whether the combine operator would be so treated because if it were a payment purely for services, I do not see that it would be a payment to him for not growing, for not utilizing his land. He owns no land.

So I see your point, and I think that may not follow. Let me put it this way: The strict payment for services using a commodity would not avoid tax under this bill.

Chairman STARK. But it would in any kind of a partnership or sharecropping arrangement?

Mr. CHAPOTON. Clearly, if they both owned an interest in the property. But if one had no interest in the property, I think it would not follow.

Chairman STARK. So then, then you are reversing what you said.

Mr. CHAPOTON. I am reversing, yes. I am reversing my answer.

Chairman STARK. What do we to do with this sharecropper, then, who tends to be poor and is used to taking a piece of the commodity? He gets stuck paying taxes, and all he has got is a warehouse receipt, or he is forced to sell and the landlord gets to postpone the income.

Is that the way it would work?

Mr. CHAPOTON. I guess I have trouble seeing how the sharecrop arrangement will continue and how the sharecropper will receive anything under this program.

Chairman STARK. That is usually the case.

Mr. CHAPOTON. Because he has not performed services. But my answer would be that I think your point is very valid, but my answer would be that the sharecropper could have taxable income.

Chairman STARK. What I am getting at is that I think really that we are getting dangerously close to making a major change in a policy, and I think both you and I would agree that we are giving a very special exemption to a group of people, and I think that once you let the camel's head in the tent—and this is the biggest camel we have ever seen—we are in danger of a lot of people dreaming up ways to postpone income.

I know you share with me the idea that that is not what we want to do. I just want to make sure that the Department in its regulations would make sure that we are not inviting participation in this kind of program by others.

Mr. CHAPOTON. Mr. Stark, we would agree with that statement wholeheartedly. I would also agree that we have to worry about the precedential effect of such items.

This is a temporary Government program. Because of the present taxation rules, it will adversely affect participation in the program. But the points you make are points that should not be treated lightly.

Chairman STARK. I would suppose, then, that you would support the concept of a 1-year sunset on this so we would have a chance to review it next year and see what the results were and what kind of special loopholes people had dreamed up, and make sure that it is applied as we are intending it be applied today.

Mr. CHAPOTON. I think we would not oppose limiting it to 1 year, if the subcommittee wishes to do that, with the idea, though, that it is a 2-year program, and we certainly would hope that it would be rolled over if those problems do not arise.

Chairman STARK. It would be easier for all of us to look at with some statistics of actual participation and actual costs rather than just looking at this issue prospectively. We may find that we have not been generous enough, or indeed, we may have been overly generous.

I guess in general, staff, myself, and many of the members, have a concern that the favorable tax treatment we are providing might encourage speculators, and in the vernacular, peddlers of tax shelters, to find in this some way that neither you nor I nor either staff have yet dreamed up to shelter income in a manner not intended by either the proponents of the legislation nor the Department of Agriculture.

Have you given any thought to how we might limit speculators?

Mr. CHAPOTON. We have discussed, Mr. Stark—and it might be worth pursuing at the staff level in more detail—the idea of limiting it to farmers with respect to their property owned on a certain date, like today. You will probably want to expand it to property received by inheritance, and perhaps intrafamily transfers.

But to prevent the Wall Street purchaser of a farm from having the benefit, certainly might be worth considering.

Chairman STARK. Would it be your thought, in view of the interest of this committee, to consult with the subcommittee on some of these proposed regulations as they are issued?

Mr. CHAPOTON. That would have to be in the bill itself. You mean the regulations on the 2032A? We have had discussions. We would be happy to have further discussions.

We have been asked to clarify the existing law in this regard, by some Members of Congress, and I have stated our views in the testimony.

So while we could have further discussion, particularly the case that I mentioned in the testimony where the entire farm might be withdrawn, but I think our views are as stated in the testimony. That would show up in regulations or rulings.

Chairman STARK. For the profitable farm, I gather there must be some, can a great deal of the income bunching problem not be eliminated or at least mitigated by income averaging?

Mr. CHAPOTON. Yes. Income averaging can certainly help. It would generally end up being taxed at a higher effective tax rate than if you—well, I should not state that unqualifiedly. It could end up with a higher effective tax rate than if you put it in 2

years. There are all sorts of variables, but income averaging can help.

Chairman STARK. Do you have any feelings on limiting the amount that a farmer taxpayer could defer?

I know that in the present law there is a $50,000 limit on certain cash payments. I am sure that has nothing to do with tax policy, but from a tax standpoint, is there any particular reason that you would see to either cap or have some kind of sliding scale on this?

Mr. CHAPOTON. No, Mr. Chairman. We have looked at that, and we think that really goes to the agriculture policy, if the amount of the payment, whatever the amount should be, received the treatment under this bill, and the amount or the limit thereon should be a Department of Agriculture policy question.

Mr. DORGAN. Mr. Chairman, if I could just make one further inquiry.

On the question of the aggregate gain or loss in taxes as a result of this law change, were you saying that under revenue estimates, the tax procedure that would be used by farmers normally, that is, reporting on a cash basis when they sold their crop, persuaded you to make certain revenue estimates at a certain level; and now PIK, with the current interpretation that the certificate would be reportable at the time of receipt, would increase or accelerate the collection above that which was estimated?

Mr. CHAPOTON. What is basically correct, yes, because if the farmer operated—let's assume there were no PIK program, then you have, in effect, a deferral of income until the crop is sold. With the PIK program and without a tax law change, you have acceleration of tax liability.

Mr. DORGAN. So in the absence of this Congress passing a bill of this sort, you would have an acceleration of revenues to the Government beyond what had been anticipated in the revenue estimating process.

Mr. CHAPOTON. That is correct. I want to add the one cautionary statement, though. I need to examine this program, these estimates in relation to the budget, what we call the baseline budget estimate, in more detail. But I think our conclusion now is as you state it. That is, there would be an acceleration of revenues.

Mr. DORGAN. Thank you, Mr. Chairman.

Chairman STARK. Mr. Moore?

Mr. MOORE. Mr. Chairman, I would say that I agree with you on your concern about possibly putting a limit on the bill's life to see to it that we do not create a problem when income is received.

Second, likewise—and maybe we can craft some sort of limits, dates or whatever, so we do not see speculators get into the farming business just to take advantage of this. I agree with you on that as well.

I have one last question, if I may, Mr. Chairman.

In line again with the estimates we have from the staff of the forgone or lost income from fiscal year 1984, if the PIK thing goes into effect, from the inheritance tax sector, the estate tax sector. I understood the Assistant Secretary to say that he had a disagreement with the staff on that. He did not feel there would be an inheritance tax due.

Is that an official position of the Department?

Mr. CHAPOTON. I think that is an official position. That indeed is the position we have taken in the testimony, though reliance on the specific application to specific fact situations of the estate tax benefit, section 2032A, would have to be the subject of a ruling.

I think such a ruling is called for in this case.

Mr. MOORE. Now you have confused me. So you make the point that perhaps if this was the position of the Department, the Department would not be trying to collect that tax. Therefore there would not be any taxes lost, in the estate taxes area.

Mr. CHAPOTON. That is correct. To be more specific, for example, in our testimony we make the point that where the entire farm is withdrawn from production under a government program, under the PIK program, then the touchstones for estate tax relief under section 2032A may not exist. I would add that caution.

And also, I am hesitant in a forum such as this to in effect make a statement that is, in effect, an IRS ruling on the application of the law to a particular set of facts. But generally, with that caveat, our interpretation of the present rules is that participation in the PIK program would not cause a farmer to lose the benefits of section 2032A.

Mr. MOORE. Therefore, there would be no instructions to the Commissioner to collect taxes.

Mr. CHAPOTON. That is why we say that the revenue loss would not occur.

Mr. MOORE. Thank you.

Thank you, Mr. Chairman.

Chairman STARK. Thank you very much. We appreciate your coming.

Mr. CHAPOTON. Thank you, Mr. Chairman.

Chairman STARK. Our next witness is the Honorable Richard Lyng, Deputy Secretary of Agriculture.

We have your prepared statement, and you may read it or summarize it or proceed in any manner you are comfortable.

STATEMENT OF HON. RICHARD LYNG, DEPUTY SECRETARY OF AGRICULTURE, ACCOMPANIED BY DAWSON AHALT, ACTING DEPUTY UNDER SECRETARY OF AGRICULTURE FOR INTERNATIONAL PROGRAMS AND COMMODITY PROGRAMS; AND A. JAMES BARNES, GENERAL COUNSEL

Mr. LYNG. Thank you very much, Mr. Chairman.

I have with me on my left Dawson Ahalt, who is the Acting Under Secretary for International Programs and Commodity Programs; and on my right, A. James Barnes, who is the General Counsel of the Department of Agriculture.

Mr. Chairman, my colleagues and I appreciate the opportunity to visit with you and other subcommittee members today to discuss the payment-in-kind program. The Department of Agriculture is giving this program top priority. There appears to be a broad consensus that the PIK program is the most effective tool available to deal with the excess supply problem currently facing agriculture.

Because of the serious problems facing agriculture, we have had to move quickly to implement this program. We cannot wait another year and let the surpluses build. Accordingly, President

Reagan announced the PIK program on January 11, 1983. Signup began on January 24 and will end on March 11, 1983.

As signup has proceeded, some producers have raised concerns regarding tax treatment of payment-in-kind commodities. Our attorneys and policy officials have been working with the Department of the Treasury and the Internal Revenue Service officials in an effort to clarify this issue. Unfortunately, the matter cannot be resolved administratively. Unless current law is changed, farmers will likely have to pay income taxes in the year that the payment-in-kind commodities are made available, not when the farmer chooses to sell them. For many farmers this would mean that income taxes would have to be paid on two crops within 1 tax year.

Since we are nearing the end of the signup period, it is crucial that tax legislation be enacted that would treat the payment-in-kind commodities for tax purposes in the same manner as normal production. This would not provide for tax avoidance. It would just mean that income tax liabilities would be applied to the tax year in which the farmer chooses to sell his payment-in-kind commodities.

Otherwise, payment-in-kind program participation could be seriously reduced and overall program effectiveness limited.

Therefore, we request that the Congress expedite legislation that would effect this change.

The balance of my testimony, Mr. Chairman, is composed of a review of the PIK program, the details of it. I will be pleased to submit that for the record rather than to go through the testimony.

At this point I would like to urge that the committee and the Congress move ahead with a simple change in the tax law so that farmers will not be taxed until the payment-in-kind commodities are sold.

We believe that this action will encourage farmers to participate in the PIK program, which, in turn, will help balance supply with demand and draw down stocks that currently overhang farm commodity markets. This action will be an important step in restoring prosperity to our Nation's farmers and ranchers and reducing the future farm program costs to the U.S. Government.

I would be happy to try to answer any questions that you may have.

[The prepared statement follows:]

STATEMENT OF HON. RICHARD E. LYNG, DEPUTY SECRETARY OF AGRICULTURE

Mr. Chairman, my colleagues and I appreciate the opportunity to visit with you and other subcommittee members today to discuss the Payment-in-Kind (PIK) program. The Department of Agriculture is giving this program top priority. There appears to be a broad consensus that the PIK program is the most effective tool available to deal with the excess supply problem currently facing agriculture.

Because of the serious problems facing agriculture, we have had to move quickly to implement this program. We cannot wait another year and let the surpluses build. Accordingly, President Reagan announced the PIK program on January 11, 1983. Signup began on January 24 and will end on March 11, 1983.

As signup has proceeded, some producers have raised concerns regarding taxation of PIK commodities. Our attorneys and policy officials have been working with Treasury and IRS officials in an effort to clarify this issue. Unfortunately this matter cannot be resolved administratively. Unless current law is changed, farmers will likely have to pay income taxes in the year that the PIK commodities are made available, not when the farmers choose to sell them. For many farmers this would mean that income taxes would be liable for two crops within one tax year.

Since we are nearing the end of signup, it is crucial that tax legislation be enacted that would treat the payment-in-kind commodities for tax purposes in the same manner as normal production. This would not provide for tax avoidance, it would just mean that income tax liabilities would be applied to the tax year in which the farmer chooses to sell his PIK commodities. Otherwise PIK program participation could be seriously reduced and overall program effectiveness limited. Therefore, we request that the Congress expedite legislation that would effect this tax change.

Now I would like to lay out some of the merits and basic provisions of the PIK program.

PAYMENTS-IN-KIND (PIK) PROGRAM

The PIK program calls for payments-in-kind to farmers who agree to reduce their production beyond what is called for in the previously announced 1983 programs for wheat, corn, grain sorghum, rice, and upland cotton. The basic concept of PIK is that farmers are offered an amount of commodity as payment for reducing additional acreage.

The PIK program has several appealing and unique features:

Production will be reduced beyond that expected under the previously announced 1983 programs for wheat, corn, grain sorghum, rice, and upland cotton, and thus bring supply back into closer balance with demand.

Stocks will be reduced at the same time that production is cut back, lessening the overhang on the market at harvest next year and enhancing the prospects for a market-led recovery in farm prices and incomes in future years.

The availability of market supplies will be maintained, signaling to exporters and importers that the United States fully intends to remain a reliable and consistent supplier when production adjustments are made. To meet our long-term export and food aid commitments, adequate reserves will be maintained.

Government outlays for domestic programs (e.g., loan volume, storage payments, deficiency payments) will decline.

The PIK program, unlike other emergency measures, is self-terminating when excessive stocks have been worked off.

Farmers will have the same of greater net returns while stocks are being reduced.

Sound conservation practices will be applied to a larger amount of acreage.

Storage space problems would be lessened.

We urge the Congress to move ahead with a simple change in the tax law so that farmers will not be taxed until PIK commodities are sold. We believe this action will encourage farmers to participate in the PIK program, which in turn will help balance supply with demand and draw down stocks that current overhang farm commodity markets. This action will be an important step in restoring prosperity to our nation's farmers and ranchers, and reducing future farm program costs.

Chairman STARK. I am sure, Mr. Secretary, that all of the members have some questions, both about the program itself, and about the tax treatment.

I would ask at this time for Mr. Flippo to inquire.

Mr. FLIPPO. Thank you very much.

Mr. Secretary, I am trying to get some idea about the magnitude of the program, about the possible size of the PIK payments and the impact of caps and that sort of thing.

I notice that we have been furnished a piece of paper that has some figures on it.

Are you familiar with this sheet of paper called Farms, acreage, production affected by various value limits?

Mr. LYNG. No, but my colleague, Mr. Ahalt, is. I am familiar with the program. I would be happy to try to answer any questions you might have.

Mr. FLIPPO. What I am interested in trying to find out is whether or not you can furnish the committee with a county-by-county list of farms eligible to participate in the PIK program, not by name, but to give us some idea about what the potential total participation in the program might be.

Could you furnish us such information?

Mr. LYNG. I am not absolutely sure we can do it on a county-by-county basis, but we could come close.

There are, of course, over 3,000 counties in the United States and I suppose at least 2,000 counties that would have participants of one kind or another.

On a national basis, our goals were to reduce the total acreage of those crops that are covered by about 13 percent, which would be a reduction of about 23 million acres. That is on a national basis. In no county would we reduce the acreage by more than a total of 50 percent, which would include not only the payment-in-kind— the maximum there would be 30 percent of the acreage on any of these crops—and the balance of that 50 percent reduction would come from the programs we announced earlier, the acreage diversion programs.

Mr. FLIPPO. Well, perhaps your colleague could discuss the assumptions underlying this analysis here.

Could you? You make some indications here that certain percentages of production would be affected and certain percentages of farms and acreage. This leads me to believe that you must have some rather extensive information on who would participate and who would not.

I wonder if you would elaborate on those assumptions.

Mr. AHALT. Congressman Flippo, the sheets that you are referring to reflect an attempt to try to estimate the number of farms and the amount of production that is involved at various acreage bases. And it varies, as you will note, significantly by type of crop.

For example, we estimate that roughly 11 percent of the corn production in this Nation is produced on farms that have a base of about 760 acres or more per farm.

Now, if you took that base and you assumed that that farm went into the payment-in-kind program, taking an additional 30 percent out of production, and you valued that crop at about $2.50 a bushel, that farm would reach the $50,000 limit. It varies significantly by crop as you can see. In the case of rice, 46 percent of the production is produced on farms that would hit that category.

Mr. FLIPPO. Could you help me understand the analysis on cotton here a little better, the $50,000 limitation?

Mr. AHALT. That would involve a cotton farm, Congressman, with a base of just under 800 acres. And if that cotton were to sell at 50 cents a pound, that farm would hit the $50,000 limit. We further estimate that roughly 40 percent of the cotton production is on farms with bases of that size.

Mr. FLIPPO. Based on those assumptions then, could you give us any idea about the median size of a PIK payment on an average farm?

Mr. AHALT. That becomes more difficult, Congressman, because of the tremendous variation in the size of farms that exists throughout the country. It makes it difficult to make an average estimate of size of farm. There are 2.4 million farms out there, and they do vary significantly.

Mr. FLIPPO. I believe the information from your analysis here is that 39 percent of the farms would probably not participate if there was a $50,000 cap.

Mr. AHALT. Absolutely. They would have to choose to either not participate or to participate at some reduced level. That is our concern, Congressman, that the payment limitation would put a severe damper on the level of participation.

Mr. FLIPPO. How long is the PIK program scheduled to last?

Mr. AHALT. You mean the signup or the program itself?

Mr. FLIPPO. The program itself.

Mr. AHALT. We have stated, Congressman, that it is a temporary program, that we are putting it into effect for 1983. It is unlikely, given the very large surpluses that we have, that we can reduce those surpluses down to the levels that are desirable in 1 year.

So barring some unforeseen events, it is likely that we would have to run the PIK program also in 1984.

Mr. LYNG. Mr. Flippo, if I might, the program is self-terminating in the sense that we cannot run a payment-in-kind program after we run out of big surpluses. So we think that, inevitably, that would take place in no more than 2 years.

The indeterminant in this, of course, is the weather. We do not know what the weather will be this year or perhaps next year.

Mr. FLIPPO. Is there no way you can give us better information about the breakdowns on these.

Mr. LYNG. We really cannot. That is why we put the limit of 50 percent in any single county, to be sure that we did not totally take out the entire agriculture in a single community.

Mr. FLIPPO. Well, it is awfully difficult to make an informed decision on the potential of this program without knowing what the potential participation might be and that sort of thing.

Mr. LYNG. We have made estimates on PIK participation, and I gave you the figure of 13 percent for the estimated reduction in acreage and the fact that it would be a total of 23 million acres.

If you would like to have that broken down by commodities, we can do that because that is the way the total was estimated.

Do you have that with you, Dawson?

Mr. AHALT. Yes, I do, Congressman.

In the case of corn, we are currently estimating that about 60 percent of the corn acreage base in this country would come in the program as we have announced it, and if we get the kind of change in the tax law that we are requesting. That 60 percent, Congressman, of participation, compares with a participation rate last year of 29.

In the case of wheat, we are expecting participation to be a little over 70 percent compared with less than 50 percent last year.

For rice, we are expecting the participation rate to go up to about 86 percent compared to 75 percent last year.

And in the case of cotton, we are expecting participation to go up to about 85 percent, compared to 78 percent last year.

So we believe that if this change cannot be made, that we will seriously jeopardize the participation in the program. I simply do not have a way to accurately predict the amount of reduction, but it would certainly be sizable.

Mr. FLIPPO. Mr. Duncan.

Mr. DUNCAN. Thank you.

Do you have other crops in surplus, other commodities in surplus that you have not included on this list?

Mr. LYNG. Substantially, these are the crops that are surplus. We do have, Mr. Duncan, commodities under programs other than the ones that I have mentioned under the PIK program. But we have other programs for some of them, dairy being the other substantial surplus commodity that is accumulating heavily in Government hands. The payment-in-kind program does not work in reducing dairy production.

Mr. DUNCAN. I didn't quite understand why you didn't include dairy products, soybeans, or tobacco. Do you have surplus——

Mr. LYNG. Soybeans are not in as heavy a surplus position. We do not have enough soybeans to begin to have a payment-in-kind program. We have——

Mr. DUNCAN. What was your explanation on your dairy products?

Mr. LYNG. On dairy products, it would be pretty hard to influence a producer to stop producing simply by giving him surplus butter or powdered milk and cheese.

Mr. DUNCAN. Do you agree with the view that the current tax laws are discouraging participation in the PIK program?

Mr. LYNG. No question about it, Mr. Duncan. If the producer is forced to pay income tax twice in a single year, he simply won't participate.

Now, we don't know how many of them would be in that position, but we think there would be a sizable number, and it would severely reduce the participation.

Mr. DUNCAN. Would it be correct to assume that farmers want statutory assurances that participation in the program will not reduce their benefits under the Federal estate tax provisions?

Mr. LYNG. I think that there would be some concerns about that, but the comments that were made by Mr. Chapoton this morning on behalf of the Treasury would be very reassuring.

Mr. DUNCAN. Thank you very much.

Mr. FLIPPO. Mr. Dorgan?

Mr. DORGAN. Thank you very much, Mr. Chairman.

Mr. Lyng, I appreciate your testimony and agree with your conclusions. You know full well that I have not been a great sympathizer with the administration's farm program over the last couple of years. I have felt that the projections have been overly optimistic, that the administration has come with too little too late very often; that we started this whole process with a form of free market chanting, export optimism that has not panned out.

In any event, PIK is the only thing that is there at the present time. And I want PIK to work. I do not think PIK is a substitute for a good farm program. I think it is a form of an agricultural fire drill to get rid of these surpluses. But I want to remove any obstacle to the PIK program to make sure that the participation in the PIK program is as broad as it can be, and that it does have an opportunity to reduce the grain stocks that are pushing down prices.

I do not think PIK alone will do it. I think that we are going to need a little luck, an expanding economy, and good participation in the PIK program.

So with that in mind, I want to ask you a question about something that was discussed a minute ago. That is, should there be a limit on the time for this legislation we are considering. My feeling

is there should be, but my feeling is a 1-year limit might be a serious mistake.

Would the winter wheat producer not be having to consider, for example, in June or July of this year, future participation in the second go-around of PIK? And if we pass a bill of this type with a 1-year limit on it, are we not endangering participation in the second year by the winter wheat producer only 4 or 5 months away from starting his 1984 crop?

Mr. LYNG. Yes, Mr. Dorgan, we would much prefer that the bill be, at the very least, a 2-year bill. We would suggest that it would be better if the bill simply made this sort of tax consideration possible whenever there is a PIK program. We do not expect the PIK program beyond 2 years, however. And a 2-year program on this would be a vast improvement over a 1-year.

Mr. DORGAN. Let me ask you, if this subcommittee just closed the tent and decided not to enact this kind of legislation, and Congress did not change the law, how damaging would the impact be to participation in the PIK program? You indicate you cannot quantify it, but just from a qualitative standpoint, how damaging would this be to the PIK program?

Mr. LYNG. Mr. Dorgan, we are so optimistic that we will get favorable action through the wisdom of this committee that we have not really planned a fallback position. But I can assure you we would not give up. We would try to figure out something that would still make the program work.

Mr. DORGAN. Mr. Lyng, your optimism has been historical, and I understand it. At least with respect to this issue, I share it.

But you are saying that even though you do not have statistics to share with the committee, that if a change of this nature was not enacted by Congress, that the lack of participation or the determination by those who otherwise would have participated not to participate, would be a very serious impediment to the success of PIK?

Mr. LYNG. It could very well be, and we think that, unfortunately, the planning times being what they are and the weeks that are passing, we have to have this sign-up period end as it is, on March 11. So time is really of the essence here.

Mr. DORGAN. Well, again, let me say that I support your efforts to make this program work. I do not think it is a substitute for a long term farm program.

Ray Charles had an old song that had a refrain, "them that has got is them that gets." That is kind of the way it is going to be under PIK. I do not like that, but I think it is probably a necessary component in order to move this surplus out and see if we cannot get back to a position where we can have a long-term program providing price stability.

You cannot have any reasonable price stability with the kind of grain stocks that we are now facing. I want to help you in every way that I can to remove this tax impediment to the success of the program.

Mr. LYNG. Thank you.

Mr. JENKINS. Mr. Lyng, I am very sympathetic to the program. I confess that I am not fully knowledgeable in the real problem of the double taxation or the like. I want to explore that just a moment.

If a farmer today proceeds to participate in the PIK program, and say he is raising corn, and he gets $100,000, use that as a figure, for half of his acreage production. Since there would be a zero net profit, he would pick up a basis of $100,000, sells it for $100,000, it does not increase his income, taxable income. Am I correct?

Mr. LYNG. There are a variety of circumstances, Mr. Jenkins, but I think that it is incorrect. If he is given $100,000 worth of corn for not producing $100,000 worth, he has some income, some gross income there. And if he has to report that in the year in which he receives the $100,000 worth of corn, that could cause him to add that $100,000 to the corn that he sold earlier in the year and totally distort his income and cause a much higher tax liability, perhaps a tax liability which he would otherwise not have.

Mr. JENKINS. I think I am missing something.

Does he pick up a basis of the value at the time that he gets the certificate?

Mr. LYNG. No. It is my understanding, Mr. Jenkins, that he picks up a basis of what his cost is. And if it is given to him, that is the basis for tax purposes.

Mr. JENKINS. You mean the basis is——

Mr. LYNG. I should be letting the people at Treasury answer that question.

Mr. BARNES. The question about basis turns on whether he has to take it into his gross income at that time. Under current tax law, the assumption would be that if he is entitled to receive this commodity, then it is attributed to him as income in this year, and the fair market value of that corn is what he would have to pay tax on. And then he would get a tax basis equal to the amount he included in his gross income.

Mr. JENKINS. I misunderstood a previous answer, I guess, by Mr. Chapoton.

I understood there would be, assuming that he had no other sales, just for the purpose of discussing the point, and he gets $100,000 in corn, and he sells it and gets $100,000, sells it the same day, what is his net taxable income?

Mr. LYNG. It would depend upon, of course, what his costs were in operating that farm for that year. If his costs were none, his net income, as I understand it, would be $100,000.

Mr. JENKINS. All right. Then he picks up nothing from the Government as far as a basis is concerned at the time he receives the certificate.

Let's use your example of no expenses on the farm, and he gets $100,000. Does he have $100,000 of taxable income?

Mr. LYNG. Yes, but I would think that he could not have a situation where he did not have some costs. But assuming that for the sake of discussion, it would be $100,000 worth of net income.

Mr. JENKINS. I misunderstood Mr. Chapoton earlier in response to a question.

Of course, one way normally that the farmer could defer income would be to defer sales on the balance of the production of his farm, could he not?

He could simply, if existing tax policy were followed and he wanted to defer income, make a decision not to sell some of his own production until a later year?

Mr. LYNG. Yes, that is correct. There have been traditionally among these large number of cash basis taxpayers, those who have been in preparation for a year of severe drought. When they do not have a drought, they have often carried over a portion of their income into the succeeding year. Even though they may have had some very difficult cash flow situations, it still was to their advantage to do that.

Along comes our PIK proposal, and a farmer who is perhaps in desperate conditions still could not participate because he sold his last year's crop, his 1982 crop, in 1983. So he just has to stay outside of the PIK part of the program in any case. That is what we are trying to get at.

Mr. JENKINS. Because he might have already made a sale of last year's crop, and this would push him up into a higher tax bracket.

Mr. LYNG. That is correct. I would guess, in all likelihood, if he had not done that, if he had sold it in 1982, then he would sell the PIK grain this year because he would need the cash. Most farmers are badly in need of cash. And if he had tax liabilities this year, he would pay them. But it is for that sizable number that have this carryover history that we are asking for this legislation.

Mr. JENKINS. If I understood your answer earlier, in view of the fact that you would anticipate our surpluses would be depleted or near depleted in the 2-year period of time, if the committee saw fit, as far as placing a time limitation on the tax deferral aspects of the case, 2 years would be acceptable?

Mr. LYNG. What we would really like to do would be to have the payment-in-kind grain handled exactly the same as if the farmer had produced it. Under those conditions, currently there is no limitation. The farmer can hold it as long as he wishes.

I can't believe, though, that it would be a very major problem for farmers if there were something like a 3-year limitation there.

Mr. JENKINS. From a practical standpoint, if you are anticipating 2 years, you would have no problem?

Mr. LYNG. I do not think there could be a major problem.

Mr. JENKINS. Thank you.

Mr. SCHULZE. I have no questions.

Mr. MOORE. Thank you, Mr. Chairman.

Mr. Secretary, it is obvious, but I would like to have it again stated for the record that it is your opinion that farmers do not have the cash to pay income tax if they were taxed on the warehouse receipt for the PIK program.

Is that correct.

Mr. LYNG. Mr. Moore, I think that many, many farmers would find that to be an impossibility. They would have to sell the commodity, the grain, in order to pay the tax. And if that were something that they were faced with, they would not participate in the program.

Mr. MOORE. If we do not have participation in the program to a significant extent, either by virtue of us not passing this tax change or by virtue of having a cap which would leave too many farmers again not participating, will the program be a success?

Mr. LYNG. I think that the program would be jeopardized, and I would doubt if it would be much of a success if farmers had to pay this double taxation.

Mr. MOORE. Mr. Chairman, I would like to ask to make a part of the record a 2-page document that we have that I believe the gentleman to the left of the Secretary has identified as his work product, figuring what would happen in in terms of farmers and the amount of acreage and production that would not be part of PIK in the best opinion of the Department of Agriculture. I would like to have that made a part of the record at this point.

If I interpret this right, what you are saying is—and I do not want you to go through all your calculations—that if you had a $50,000 cap on the value of the payment-in-kind a farmer could receive, you would be eliminating about 11 percent of the production of corn, 8.4 percent of the production of sorghum, 18.5 percent of the production of wheat, 46 percent of the production of rice, and 39 percent of the production of cotton, possibly from the PIK program, is that correct?

Mr. AHALT. That is correct.

Mr. MOORE. That would be such a substantial elimination that you would be thereby jeopardizing the program?

Mr. LYNG. I think it would jeopardize the program. And I would like to point out that we are, on these larger payments-in-kind, giving those to people for a large reduction in production. It is not that it is something additional. They are limiting their production by reducing their acreage by a certain percent of their base in order to get a payment of 80 percent of their normal yield in corn, rice or cotton, and 95 percent on wheat for the reduced acreage. The payment in kind is only a replacement in part of what we have asked them to reduce the crop. It is quite important that we get those larger producers into the program if we are going to get the tonnage reduction that is required.

Mr. MOORE. Is not about the only hope a small farmer is going to get out of this is if most of the farmers participate in the program so you have a reduction in the planting so that the price will begin to come up to a fair market price for farmers make a profit?

Mr. LYNG. That is absolutely correct, Mr. Moore.

Mr. MOORE. Therefore, if we have farmers not participating and you do not have that reduction in planting, you will not see any kind of movement in the marketplace, and the small farmer and all farmers are going to wind up being hurt?

Mr. LYNG. That is absolutely correct.

Mr. MOORE. And ultimately the taxpayer is going to pay for that through CCC commodity purchases under the various support programs?

Mr. LYNG. Yes. Unfortunately that is the case.

Mr. MOORE. Mr. Secretary, an article appeared that all of us saw, and it disturbed us, February 21, 1983, in the Washington Post by Mr. Ward Sinclair, talking about the possibility of cotton farmers making a lot of money under this program.

Did you see that article?

Mr. LYNG. I did, yes.

Mr. MOORE. I have seen an analysis that indicates that what was wrong with that article, a very telling defect, was the fact that the

author did not include fixed costs being taken into account of what the ultimate profit would be.

What is your analysis?

Mr. LYNG. Well, when I read that, I thought many, particularly those cotton farmers in the west, in my home State of California, would be shocked to learn that growing cotton was such a profitable business. There was a mixture of understanding there, or a lack of understanding, of all of the costs that go into the production of cotton, and it misstated the situation.

Mr. MOORE. The article talks about the net over variable cost—I think those were the figures that were printed in the paper—as if that were a net profit.

Is a net over variable cost figure a net profit figure to a farmer?

Mr. LYNG. Not at all. The fixed costs are in many cases greater than the variable costs. It varies by crops, of course, but for those crops that require heavy capital investment, the depreciation, the taxes, all continue whether you produce a crop or not.

Mr. MOORE. If you used the USDA beltwide, let's see, the USDA beltwide estimate for fixed costs in the case of these cotton farmers, and you subtract that from the figure net over variable cost, do you wind up with a profit or a loss?

Mr. LYNG. I am sorry, Mr. Moore, I was not listening closely enough to the question.

Could you repeat it?

Mr. MOORE. If you assume USDA's estimates of the cotton beltwide fixed costs, realizing it varies from farm to farm, but taking USDA s estimates of the average, if you subtract that from the net over variable costs which appeared in the Washington Post story, do the cotton farmers come out with a possible triple profits as is indicated in that story or, in fact, a loss?

Mr. LYNG. No. There is no chance for anyone to have a triple profit. I suspect that there would be very little real profit at all, that this might vary depending upon the base, the historical base that the individual farm had. But I think that cotton farmers today understand that this program is, as Mr. Dorgan pointed out, an emergency program. It is something that is needed to bring the supply and demand back into some kind of balance. The situation is pretty desperate out there.

This is not a program designed to make cotton farmers rich by any means.

Mr. MOORE. The last question I would ask is the fact that will there not be a positive budget impact by the successful implementation of the PIK program?

Mr. LYNG. Yes, it will have a favorable impact on the budget, but it is going to take a bit of time. In fiscal 1983, it will have very little impact on the budget. In fiscal 1984 I believe we estimated that it would reduce the cost of the Commodity Credit Corporation by something like $2½ billion which would have some beneficial effects over the next few years.

Mr. MOORE. What was that figure, again?

Mr. LYNG. $2½ billion in the budget for fiscal 1984.

Mr. MOORE. What makes up those savings, that $2.4 billion?

Mr. LYNG. We are hoping to see higher prices, smaller quantities coming into the Commodity Credit Corporation, smaller deficiency payments, and an improved marketing situation.

Mr. MOORE. And reduced storage costs?

Mr. LYNG. And reduced storage costs and interest costs as well, yes.

Mr. MOORE. Mr. Chairman, I would ask permission to have included in the record this worksheet of the witness. I think the chair had not ruled yet.

Chairman STARK. Without objection. It is my understanding that the numbers are similar to some that staff has proposed. Without objection, I would be happy to make it a part of the record.

Mr. MOORE. Thank you, Mr. Chairman.

[The information referred to follows:]

Farms, Acreage, and Production Affected by a $50,000 PIK Value Limit (Based on 1978 Census)

Corn

Value per Unit — Yield

$50,000 ÷ $2.50 = 20,000 ÷ (110 × .80) = 227 ÷ .30 = 757

Farms	Acres	Production
6548	4,194	
2550	3278	
9098	7,972	847 910
919,297	79,114	7,670, 340
1%	10%	11%

Sorghum

50,000 ÷ 2.35 = 21,277 ÷ (60 × .80) = 443 ÷ .30 = 1478.

Farms	Acres	Production
856	1436	60 674
136 929	141,064	718, 108
< 0.6%	< 10%	< 8.4%

Wheat

50,000 ÷ 3.50 = 14,286 ÷ (35 × .95) = 433 ÷ .30 = 1443

Farms	Acres	Production
6294	10,031	299,312
383,367	54,458	11,616,060
< 1.6%	< 18%	< 18.5%

BEST COPY AVAILABLE

Rice

$50,000 ÷ 8.14 = 6,143 ÷ (46 × .80) = 166 ÷ .30 = 553

Farms	Acres	Production
1201	795	35,934
373	569	26,094
1574	1364	62,028
10,849	3,003	133,764
14.5%	45%	46%

$100,000

373	569	26,094
10,849	3,003	133,764
3.4%	19%	20%

Cotton

$50,000 ÷ .50 = 100,000 ÷ (525 × .80) = 238 ÷ .30 = 794

(.41 of 500-999)

Farms	Acres	Production
2029	1372	1108
1777	3164	3083
3806	4536	4191
53,819	12,737	10,716
7%	36%	39%

$100,000

1777	3164	3083
53,819	12,737	10,716
< 3.3%	< 25%	< 29%

BEST COPY AVAILABLE

Chairman STARK. Mr. Secretary, as you were suggesting to Mr. Moore, this would reduce production and certainly reduce the surplus. Would not the net effect, if your program is successful, be to increase the price in out years that the farmer will receive for the grain or corn or cotton?

Mr. LYNG. We hope so, Mr. Stark, but we really do not think it would have much of a substantially favorable effect in 1983 because the heavy inventories——

Chairman STARK. What do I tell my district, we are neighbors in California by a few hundred miles, I know what you can tell the cotton farmers in Modesto, but what do I tell the people who are out of work at the Fremont auto plant where the net result of this bill is to increase the cost of their bread and their cereal and other protein. What is in it for them?

Mr. LYNG. Mr. Chairman, what is in it for everyone in this country is a healthy farm economy, which is absolutely essential. It is, I think, a very basic part of the economy that we simply cannot neglect.

Now, the fact that we need higher prices for farmers is not necessarily bad news for consumers. The difference in the consumer price that would be required to make farm income or farm prices satisfactory is very, very slight.

Chairman STARK. What do you say to the guy who has been out of work for 2 years at the Fremont General Motors plant and you are now talking about making him count food stamps as part of his ability to qualify for other Government aid. And, this bill will increase the cost to the Agriculture Department of the food stamps.

How does that wash? You want to help the Robinsons and the Boswells in your hometown, while trying to cut the poor people out of work in my hometown.

Is there some way we could kind of move a little closer together?

Mr. LYNG. Mr. Chairman, we can. In our home State of California, one out of every four people is involved in agriculture in one sense or another. And if we have a healthy agriculture, you have an impact upon those jobs.

Further, we are not going to impact the food stamp benefits. Food stamp benefits are calculated based upon the cost of food. If food goes up, the food stamp benefits will go up.

Chairman STARK. As part of your administration's program, you are suggesting that we change the disregard for the amount of food stamps for the very poorest of the poor, or disabled people, to qualify for supplemental security income, they have to have incomes of less than $200 a month. By making them include the value of food stamps, you are making it more difficult for those very, very poor people to qualify for supplemental security income.

Do you think that this is not an issue of equity. If we are going to give a lot of help to these farmers across the country, do you think it is fair to knock some people, really the poorest of the poor, out of these programs because they receive food stamps?

Mr. LYNG. We have been very careful, Mr. Chairman, not to make any proposals that would knock the poorest of the poor out of the food stamp program. Our major proposals this year are totally different than that.

I would like to think that what we are talking about here is unrelated, really, with the food stamp program.

Chairman STARK. Mr. Secretary, that is not true. I used to chair the Public Assistance Subcommittee and many of my colleagues served on it with me. They are both welfare committees. We just move the decimal point five or six places one way or the other and do the same thing. In one committee we help people through the Tax Code, and in the other committee we help them through supplemental security income or aid for dependent children.

Basically, what has been suggested—and I only use this forum because it is so seldom that we get the Agriculture Department in a posture where they might want to cooperate with our committee—is that you reexamine the administration's position on taking food stamps into account in determining SSI eligibility.

The administration is proposing that the value of the food stamps they are now receiving be included in that income test. And so suddenly, if they are making $180 or $200, and they get $49 worth of food stamps, they will not get the few dollars in supplemental security income.

The cost to the Government is miniscule compared to what the cost of this program could be.

I am just asking for your support; if we cooperate, as I suspect we will, in taking care of your neighbors, maybe we could get a little cooperation back the other way. As a part of equity here, just for another year or so, we would withhold including the value of those food stamps in the calculation of whether or not somebody qualifies for SSI.

You and I would feel a lot better about the people we help, and I do not think, if this bill is not going to hurt the budget any, my tradeoff is going to be even less noticeable.

Mr. LYNG. Mr. Chairman, we certainly do want to cooperate, and we want this legislation.

This program you are referring to is a proposal of the Health and Human Services Agency, and I would be happy to talk to them about it.

Chairman STARK. We appreciate that.

Are there any further questions for the Secretary?

Mr. Dorgan?

Mr. DORGAN. I wonder if I might, Mr. Chairman, point out that I tell the people in North Dakota, when they talk about food costs, that the consumer in this country gets the best quality food at the lowest percent of their disposable income of any major industrial nation on Earth. And that is the thing I think to tell the folks that go to the grocery store. Much of that is at the expense of the family farmer.

The problem here is that the boat is sinking. I think we have to reorganize the passengers on the boat, too, at some point. First we have to plug this leak in the boat and keep the boat afloat. That, I think, is what the PIK program is all about.

Mr. Chairman, I certainly share your instincts about what percent of the farm program goes to the largest farms. And the structures report, which the USDA has not seen fit to use much, demonstrates clearly that that is exactly what is happening in farming.

I would like to ask a question, if I might, of the Secretary.

When would you be announcing the second phase of the PIK program? When would you be announcing a PIK program for winter wheat next year, assuming you decided to go ahead with it?

Mr. LYNG. Well, Mr. Dorgan, as you well know, we are always criticized for not getting our announcements out early enough on winter wheat. We have a bit of a problem because the full harveset of spring wheat is not completed. We will do it as early as we can. I would think our target date would probably be the September 15, something like that. I think we should by that time begin to have some feeling for the harvest of the 1983 crop.

The main thing we want, before we can make plans for 1984, would be to have some feeling for what kind of yields that we are going to have in 1983.

Mr. DORGAN. Is your best guess today that there will be a second year, at least for winter wheat producers?

Mr. LYNG. Yes, I think probably that we will have one because of the size of the carryover. But it is not necessarily a certain thing at all.

Mr. DORGAN. If there would be one for winter wheat producers, would that necessarily mean there would be one for spring wheat producers?

Mr. LYNG. I think yes. I would like to review that, but it seems to me that if you have a program for wheat, you have to have a program for spring wheat.

Mr. DORGAN. When do winter wheat producers begin making planning decisions?

Mr. LYNG. For winter wheat producers, I am sure late summer, at the latest, early fall.

Mr. DORGAN. I am just asking that in terms of the time limitation.

Finally, just let me ask a question about the questions Mr. Moore was asking.

You would admit, would you not, despite the dialog here, that there are some people who might well be getting a significant windfall under the PIK program?

Mr. LYNG. We have tried to make the program attractive, Mr. Dorgan, to get participation. We have tried to structure it to make it an attractive, generous program, but not a windfall.

Mr. DORGAN. I support the program, but I swallow a little hard in some respects in doing it. Nevertheless, it is necessary and we have to patch this boat up to keep it afloat. But it seems to me that there will be some windfalls. I got the feeling that you were saying, well, we are not talking about windfalls. I suspect that there are going to be some windfalls.

Thank you very much, Mr. Chairman.

Chairman STARK. Mr. Moore.

Mr. MOORE. Mr. Chairman, I have just one last question I would like to put to the Secretary, in line with a recent line of questioning.

Mr. Secretary, is it not true that somebody has got to pay for the commodity? You are either going to pay for it by the consumer in the marketplace or the taxpayer is going to pay for it through subsidies. It is going to be paid for one way or the other.

Mr. LYNG. That is correct.

Mr. MOORE. And have not the last four, I guess, administrations, Nixon, Ford, Carter, and Reagan, all determined that it is better to be paid for in the marketplace, that it is cheaper to the taxpayer and consumer, and it is also better social policy?

Mr. LYNG. We have been trying to move in that direction since the late sixties, Mr. Moore. We have not done it with a great deal of perfection. But that has been our goal.

Mr. MOORE. Thank you.

Chairman STARK. Thank you very much, Mr. Secretary.

Mr. LYNG. Thank you.

Chairman STARK. It is my pleasure to welcome to the witness stand a member of our committee. We look forward, Mr. Hance, to your testimony.

Mr. HANCE. I can see that the crowd fell off slightly.

Chairman STARK. We have your prepared statement, and without objection we will put it in the record, and then you may proceed in any manner that you see fit.

STATEMENT OF HON. KENT HANCE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. HANCE. Mr. Chairman, it is my pleasure to appear in front of such a distinguished group, such an intelligent group, and a group that I highly respect. I appreciate Mr. Dorgan stopping before he got out the door as he started to leave. I appreciate his friendship, and also appreciate Mr. Duncan staying, and I hope the others did not get trampled in the stampede.

But rather than belabor you, I would like to leave hoping that you would feel somewhat indebted to me. So therefore, I would not read my testimony, and just summarize it quickly.

The main problem with the PIK program is that it is about 3 or 4 years too late. This administration and the last administration ignored the farm problem, and we kept telling them that it was a severe problem that needed immediate attention. Now this administration has recognized that it is severe. The PIK program is trying to address some of these problems.

The main thing I want to point out is that if we do not have large participation, then the program will not work. If the commodity certificate is going to be taxable in the year that a farmer receives it, that is going to have an adverse effect on the sign-up, I am afraid.

Also, as I discussed with you yesterday, Mr. Chairman, I wanted to put in my two-bits worth against any type of cap on the deferral issue. I understand what you are trying to get at when you suggest imposing a cap. As does Mr. Dorgan, I can see the problems with this issue, but at the same time, if the larger producers do not participate in the PIK program, then the end result of what we are trying to get to is not achieved.

There are two other issues that I want to touch on just briefly. The first one has to do with the co-ops. I think you are all well aware of the problem they face without this legislation. I would hope that you can take these problems into consideration during your markup.

Also, on the estate tax special valuation issue, I do not perceive any major problems that can't be solved during markup.

I appreciate the opportunity to be here.

[The prepared statement follows:]

STATEMENT OF HON. KENT HANCE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Thank you, Mr. Chairman, for the opportunity to come before my distinguished colleagues and clear up a potentially devastating shortcoming in the Administration's Payment-In-Kind, or PIK, program.

Many farmers, especially those in my West Texas District, are refusing to sign up for PIK because of the possible adverse tax consequences. PIK is supposed to help our farmers out of the financial depression they are facing today, not create additional tax problems.

As the PIK program now stands, farmers who sign up for the program and receive commodity certificates from the government in exchange for idling up to fifty percent of their land will be taxed on the certificates in the year they are received rather than the year they are sold. In other words, the farmers will have to pay taxes currently on the certificate even if he or she does not actually receive income until the certificate is sold the following year.

Under normal circumstances, the IRS will not require the farmer to declare income from a crop except in the year that he sells the crop. Under the PIK program, however, the tables have been cruelly turned on the American farmer. Instead of offering the farmer a helping hand, we are tossing him a live hand grenade.

The PIK program as it exists would also create adverse tax problems for farmer cooperatives, and could jeopardize the special current use valuation available to farmers under the federal estate tax laws. In addition, other various tax problems with PIK also need to be addressed and remedied. The guiding principle should be that the PIK commodity should be treated just like the farmer's crop.

These unresolved tax issues have clouded the PIK program, and pose a severe threat to PIK's success. The success of PIK depends on wide-spread participation by the American farmer. If these tax questions are not cleared up, many farmers will refuse to sign up for PIK, and the efforts for supply control will fail miserably.

In my district, Mr. Chairman, we are facing depression-like conditions on the farm. The FmHA delinquency rate in my district is about 93 percent and PIK is viewed as a possible stop-gap solution.

But without the provisions called for in H.R. 1296, the farmers will avoid PIK like the plague and for good reason. We cannot expect our farmers to pay taxes on a commodity certificate that they have not realized any income on. We are telling a financially hurting segment of our economy that we want money for Uncle Sam before they even have it in hand.

If this happens, it would severely affect the goal of the PIK program which is to reduce supply. If large producers choose not to participate in PIK, supply will remain high and the price will remain depressed for the smaller farmers selling their PIK certificates in the market.

That, Mr. Chairman, is simply not fair and should not be tolerated.

PIK is not perfect, but by passing H.R. 1296 we will take a long stride toward fairness and equity.

The bill simply gives our farmers the option of deciding whether they want to declare the PIK commodity certificate as income when they receive the certificate or when they sell it. It also rectifies the estate tax problems that farmers could experience. It gives our farmers the greatest flexibility in handling an already dismal financial situation. It is important that this legislation be amended, however, to solve the potential tax problems that would develop for farmer cooperatives, and to remedy the other tax problems that have surfaced.

For PIK, it could mean the difference between success or failure. And time is running out. Farmers have until the close of business on Friday, March the 11th, to sign up for the PIK program.

If PIK fails, our farmers will continue the slide toward certain bankruptcy. We must encourage our farmers to take their land out of production or we will never solve our oversupply problem. And as long as we have such an oversupply, we will continue to see depressed prices.

And depressed prices lead to more and more family farm failures . . . more and more foreclosures and auctions . . . More and more heartache and suffering from one of America's most productive and efficient set of workers.

Also, Mr. Chairman, I would like to speak out against any cap on H.R. 1296. If we set a limit on the amount that can be deferred from one tax year to another, we have given the large producer every reason not to participate in PIK.

Farmers in my district must invest a substantial amount of money just to put a crop in the ground. If we rob the large producer of any incentive to participate in PIK, he or she will plant row to row and fence to fence and the PIK program will fall prey to yet another misguided notion by Congress.

We must not lose sight of our objective. We must give our farmers the incentive and the help they need to not produce those commodities in critical oversupply.

We, the taxpayers, have to pay out billions of dollars in storage, transportation, and other government programs to the farmer as long as we have the oversupply problem.

As a member who represents an agriculture district, Mr. Chairman, believe me when I say that PIK isn't something to write home about, but right now it is the only game in town.

We have got to encourage our farmers to participate and H.R. 1296 provides that encouragement.

Thank you.

Chairman STARK. I thank you very much for your concise and enlightening testimony.

Mr. Dorgan, any questions?

Mr. DORGAN. No questions.

Chairman STARK. Mr. Duncan?

Mr. DUNCAN. I have no questions. Thank you.

Chairman STARK. Thank you very much. The people in west Texas are well represented. The farmers can sleep well tonight.

Thank you.

Mr. HANCE. Thank you.

Chairman STARK. It is now my privilege to call Congressman Harkin, the author of this legislation, a man for whom every farmer in Iowa should have a deep and abiding affection and respect.

And Tom, we have a copy of your testimony, I believe. It will be made part of the record.

You may proceed in any fashion you desire.

STATEMENT OF HON. TOM HARKIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. HARKIN. Thank you very much, Mr. Chairman.

Like Mr. Hance, I will not read the statement. I would just like to summarize a few of my feelings on it.

Before I do that, I just want to thank you, Mr. Chairman, and to thank the chairman of the full committee, Mr. Rostenkowski, and the other members who are here today for the expeditious handling of this bill. I know that you recognize the problem that we are facing in agriculture with the tax consequences of the PIK program. And rather than all of the farmers perhaps being indebted to me and others who have been pushing this legislation, they really ought to be indebted to you and other members of the Ways and Means Committee for taking time away from your important task of working out the social security problems to address this problem. So I am just very thankful for this opportunity and for your having this hearing and hopefully a markup very soon.

Mr. Chairman, I would just say that my feelings are that we need a simple bill that will tell the farmers what their tax consequences are going to be before March 11. The sign-up for the PIK program has slowed considerably. A number of farmers have told

me personally that even though they put their offer in, as you know, they have until March 11, to take their offer back out. They are waiting to see what happens on this. If nothing happens by March 10, I predict there will be a lot of farmers who will go into the local offices and withdraw their bids on that last day.

The second point, I think, in terms of equity, is that there are a lot of different ways of looking at equity. I appreciate what you said a little bit ago, Mr. Chairman, to the Assistant Secretary. It needed to be said, and very pointedly, and you did it.

But there is another kind of equity, and that is that farmers, regardless of their stripe, regardless of how big or small, farmers ought not to suffer because they participate in the program.

I might diverge just a little bit from what my colleague, Mr. Hance, said. I was here in the Ford and Carter administrations, and now under the Reagan administration. I have been on the Agriculture Committee all that time. Quite frankly, under Bob Bergland, who was then Secretary of Agriculture, we did enact the farmer-owned reserve program and coupled it with a set-aside and diversion program, and it worked. And it worked because we were dedicated to insuring that we had a good supply management program in Government.

When this administration came in, even though they gave lipservice to the programs, quite frankly, in 1981 and 1982 there really was no program. There was a program, but it was so meaningless that farmers did not sign up for it. So consequently, we find these huge surpluses hanging over our heads.

Again, it is another example, I think, of how we can be pennywise and pound foolish. I think if this administration had seen in 1981 and 1982 that by the expenditure of a small amount of money for a set-aside and diversion program, we would not now be facing some of the problems we are facing with the PIK program.

The third thing, Mr. Chairman, is that a farmer should pay his taxes on this PIK stuff as though he had grown it himself. I think that is really the nub of the whole thing. The bill that I introduced and which you will be working off of, for which I am also grateful, has basically the following provisions.

It gives the farmer the option to defer the payment-in-kind grain just as if he had grown it. So he pays his taxes, but he has an option to pay his taxes when he sells it or when he sells the cattle that may consume the grain.

The other part of the bill—and it really has not been discussed a great deal here this morning, Mr. Chairman—has to do with the treatment of the farm for estate tax purposes if a farmer participates in the PIK program. I would only say, Mr. Chairman and members of the committee, that there seems to be some divergence between the policy arm at the Treasury Department and the technical arm.

The technical people seem to say that there is a great problem. The policy people, Mr. Chapoton, who was here this morning, I was very surprised to hear him say that there was no problem. So there seems to be some divergence there.

I do not pretend to be an expert in the area of 2032A and the tax consequences, but I do understand that the Treasury could in fact penalize a farmer for going into the program by excluding from the

special use valuation under 2032A that portion of his farm that may be put into the PIK program. It could penalize the farmer who is, let's say, now farming, who is going to leave the land to his heirs. It could also penalize the farmer who may be in the program this year and dies while the land is in the PIK program. Of course, then it is not being used in a qualified way at the time of death.

I have already heard from a young farmer in my district who inherited land from his father and who wants to go into the PIK program. He is concerned that he could lose his benefits even if he farmed for the 10 years afterward that he has to farm it.

So there are some real problems in the estate tax purposes. That is why I wanted to address it in my bill. I hope the committee will continue to look at that.

I would only recommend that you perhaps listen to what Dr. Neil Harl has to say when he is up here on the panel, and then quiz him on that. He is, without a doubt, one of the country's leading experts in this whole area. I am sure he can address this whole problem of 2032A and treatment of the estate for estate tax purposes under this PIK program.

Lastly, Mr. Chairman, I would just say that I know your feeling about the tax consequences. The Congressional Budget Office has said that because of reduced storage, interest, and deficiency payments, there will be about a $5 billion savings over 3 years. So while there may be some tax consequences——

Chairman STARK. Would you yield there at that point?

Mr. HARKIN. Yes, Mr. Chairman.

Chairman STARK. That presupposes, as I understand, that we are using commodities in storage to pay what otherwise could be cash payments, and that if you go o[illegible] enough,, that savings does not actually show up, that you d[illegible] the storage and the interest costs and those sorts of thin[illegible]t I believe that the overall effect is to give about $4 bil[illegible]a t[illegible]rs in crops.

And although we have [illegible]ead[illegible] for that commodity somewhere in the past, I am not sure [illegible] really is, in the entirety, a real saving; is it?

Mr. HARKIN. I think so beca[illegible]he fact that you do have the farmer-owned reserve n[illegible] Again, there is another equity argument there.

Chairman STARK. I guess what I am saying is if we did not give them those crops, we would sell them. And then the Government would get $4 billion, or whatever it is worth, when it sold it.

Mr. HARKIN. Except, Mr. Chairman, if the PIK program does not work, farmers, of necessity, because of the marginal cost of planting more grain, will grow another huge crop this year. And so it will continue to build up.

Chairman STARK. I have no quarrel that the plan, if it works as intended, will help. What I am saying is that the idea that we are creating something new only supposes that we would not sell the grain.

Mr. HARKIN. My staff just informed me there is one other problem, too, that I forgot to mention. There are restrictions in the law that the Government cannot sell the grain until it gets to a certain price. For example, corn that I know the most about, the price right now is $3.25 a bushel.

Chairman STARK. We can sell it overseas though under that law.

Mr. HARKIN. I would have to check on that.

[Pause.]

Mr. HARKIN. I am informed that the restrictions also apply on sales overseas of grain. They cannot sell it for less than that overseas.

Chairman STARK. I just raise the question. Somebody has hinted that somehow we are creating $4 billion of assets that did not exist before.

Mr. HARKIN. I do not know. That may be kind of spurious, although I do think that what may be costing us in terms of some tax expenditures, unless of course, we are going——

Chairman STARK. Tax expenditures are not that significant.

Mr. HARKIN. I do believe that it may cut down, as I said, on some of the storage and deficiency payments.

Thank you, Mr. Chairman. I really do not have anything more to add to that.

[The prepared statement follows:]

STATEMENT OF HON. TOM HARKIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

I want to thank the Ways and Means Committee and the Subcommittee on Select Revenue Measures for the rapid action they have taken on H.R. 1296, which I introduced only sixteen days ago.

I appreciate Chairman Rostenkowski and Chairman Stark's quick attention to this question, especially at a time when the Committee is so very busy on the crucial question of Social Security.

On January 11th, the Department of Agriculture announced a "Payment-in-Kind Program" (PIK) involving five commodities—corn, wheat, sorghum, cotton and rice. The program is designed to reduce the huge surpluses that exist in these commodities and thus reduce the tremendous costs the government would otherwise incur.

I am hopeful that we will also see higher prices so that farmers might survive.

PIK calls for farmers to take land out of production. In exchange for each acre removed, a certain amount of a commodity will be turned over to the farmer. The farmer must also set aside a certain percentage of the land, varying with the commodity, in order to paricipate and another percentage of land for which a cash payment is awarded.

The farmer must decide to participate in PIK by March 11th. Any participants who leave the program after that date will be assessed a large cash penalty.

Even if the date were administratively changed, the planting season requires farmers to make their decision soon!

Essentially, we have a swap: The government trades the actual production the farmer would have grown for grain—or its equivalent—that the government has—or will have—in its stock.

In exchange, the farmer gets a quantity of the crop that he would normally plant. The amount has been adjusted downward to take into account his reduced costs for not having actually planted and harvested. Of course, the farmer must still pay for his land and machinery.

It seems like a simple swap. However, as I was informed by hundreds of farmers during PIK meetings in January, things aren't as simple as they appear. All of those Iowa farmers wondered how their grain would be taxed. Subsequent research revealed that joining the PIK program may create a number of problems. Problems that would not exist if he just went ahead and grew the crop in the normal fashion.

In the interest of fairness, I hope that the Congress will allow the farmer to know the tax consequences of what he is getting into while he still is able to make a choice. If the choices are adverse or if the farmer is uncertain, he might not sign up and the government's program would be undermined.

The underlying philosophy of H.R. 1296—which is supported by 67 Members of the House—is to treat the benefits of the set-aside program as if the farmer had actually grown the crop.

First, there is the question of when the commodity received is to be designated as income. Normally, the 98 percent of farmers who operate under the cash method

accounting would not be taxed until they either sold their crop or until they sold the livestock that were fed the crop.

Without this bill, present law would provide that the farmer was in "constructive receipt" of an asset, when he received that asset: the crop commodity.

This would cause a serious problem because many farmers have—or will—under normal circumstances, sell last year's crop this year. As a result, they would have to pay the taxes on two year's worth of crops in one tax year. But, they would only have business deductions for one year. This is the so-called "bunching" problem.

H.R. 1296 allows farmers to treat their PIK payment as if they had grown the commodity themselves. And it would be taxed in that manner.

The bill also provides the option of treating the commodity as if it were a cash payment, because many farmers may have signed up with the expectation that it will be taxed in the year received.

Other farmers will actually receive, in substance, the forgiveness of a commodity credit corporation loan instead of a commodity. When the loan is forgiven, they get the use of their own crop from a previous year (that was under government seal).

Some farmers had decided to treat the loan as just that, and as a result they have not paid taxes on it yet. H.R. 1296 treats this situation in the same way that it treats the regular case. The farmer would treat the forgiveness of the loan in much the same way as if he did not happen to have a loan with the Commodity Credit Corporation and had received the grain.

I would also note that it is very important to treat the PIK payment or loan forgiveness as if the farmer was the producer of the commodity. If this is not done, numerous special provisions in the Code such as Section 175—which deals with soil and water conservation expenditures—would not be available to the farmer.

The last point on income taxes concerns farm cooperatives. If PIK commodities are not considered to be patron source producer goods, the cooperatives risk their nonprofit status.

The PIK program's greatest tax impact on farmers may be estate taxes.

As PIK is now constituted, it poses a grave threat to farmers' ability to participate in the special use valuation provisions of the estate tax laws.

On many small or middle-sized farms—where the farm family's net income might average $25,000 a year or less—the normal value of the farm could approach a million dollars. If the farm is to be passed down to the next generation, the farmer must be able to participate in the special use valuation procedure—Section 2032A.

Two tests must be met for qualifying: The farmer or his family must materially participate in the operation of the farm. And the land must be in a qualified use.

H.R. 1296 provides that all of the land set aside should meet those two tests.

It recognizes that we do not want to predetermine that a participant meets the requirements of the provision—it just covers the land set aside for the years involved.

We have three separate time periods involved: before death; at death; and post death. The last two cases are most crucial.

Without a bill, if a farmer were to die in the year that he participated in PIK, the land involved would not qualify for special use.

In this instance—since few people can predict when they are going to die—participation in PIK jeopardizes the farmer's ability to pass his farm on to the next generation.

Failure to resolve this question may dramatically affect participation, because many farmers may drop out of PIK when they realize that they are risking the loss of their special use benefits.

Those who inherit the farm under special use face certain danger.

As soon as the farm is not in qualified use, the government recaptures all of the special benefits received. Even if the land being operated by family members is being used as a farm, PIK participants will lose all the special benefits for the land unless legislation is passed.

Now, I understand, some fear that there could be abuse if this bill is opened too widely. Such abuses include land speculation that would drive up the price of farmland and the spectre of tax avoidance.

I believe that such activities will be minimal.

In the first place, there is uncertainty. Even if you waited after the bids were accepted, you'd have no idea what next year's program would look like.

From the estate tax viewpoint—you'd have to meet the 5-out-of-8 year rules on the pre death side and your family would have to farm the land for ten years after your death.

Given so many variables, I do not believe that land would be purchased for this reason. Speculators would be scared off by the fact that farmland prices have been

falling over the past year. In short, neither farming or farm speculation are a safe gamble.

Finally, I would conclude by saying that I hope that the Committee will be able to report a straight-forward bill along the lines of H.R. 1296.

Farmers have until March 11 to make their final decision on PIK participation, so if the bill becomes too complex, sound evaluation will be difficult before the deadline.

If action is delayed, farmers will be in a real quandry: The government will have placed them at great risk for participating in a government program.

Lastly, I would like to say something about the revenue impact of this bill. While Treasury may show substantial impact from present law, we must remember that the bill would cost nothing at all compared to the revenues that Treasury would have received without the program.

If the program works, Treasury will gain revenues because farming will become more profitable in the future without the huge oversupply of commodities depressing the market. And, the government will reduce its costs.

Again, I appreciate the Committee's concern with this problem.

Thank you.

Chairman STARK. Thank you very much, Congressman Harkin. You are to be commended for a good effort on behalf of the farmers of America.

Mr. HARKIN. Thank you.

Chairman STARK. Some of you have been waiting a long time.

Let me call, if I may, to the witness stand at this time Hon. Berkley Bedell from Iowa and Ms. Smith from Nebraska, and Mr. Stenholm of Texas, and Mr. Durbin of Illinois, and ask if maybe you would all come to the witness stand together and each make your statement.

I am sure some of the members may want to question you, and we will save a little time.

All of you have prepared statements, I believe, and without objection they will appear in the record in their entirety.

Berk, if you want to proceed first, you may summarize or add or proceed in any manner you feel comfortable.

Mr. BEDELL. Mr. Chairman, Mr. Stenholm says he has another commitment he has to make. Would it be all right if I yield to him?

Chairman STARK. Fine.

STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. STENHOLM. Thank you, Berkley, and thank you, Mr. Chairman.

I particularly want to commend you for holding this hearing today. It is very timely. It is on much-needed legislation.

I will take just a moment to summarize the statement that I have presented to the committee.

I think I want to emphasize and underline that the PIK program is a substitute for and therefore ought to be equivalent to a normal crop, and that the tax treatment should be that this is a crop grown rather than the complexities of trying to understand the PIK.

I think that it is very important to pass the legislation our colleague, Mr. Harkin, has introduced, of which I am a co-sponsor.

I also want to briefly mention two other concerns for this committee's consideration. First, there is some question in regard to our cotton and rice cooperatives which market commodities for many producers, that they would be at a tax disadvantage simply

because they might be handling a commodity not physically produced by one of their members, that is, nonmember business. I think the subcommittee would do well to consider appropriate action to clarify this situation, and I understand at least one member of the committee is going to attempt to deal with this with an amendment. I would urge your consideration of this.

Second, I would urge you to be most cautious about doing anything which might tend to set a monetary value on PIK. USDA's authority for carrying out this program depends on their assumption that there is not a definite set value associated with these commodities. Therein is the entire reason for this legislation—that it is taxable only when you receive the dollar value. There is considerable question today as to the value and rightfully so. I think we would jeopardize the program if we upset that basic assumption at this point in time.

I think the main thing is the taxation question. It seems logical to me as a farmer, myself, to treat PIK payments as equivalent to harvesting the crop and allow it to be counted as income under the cash basis when I actually receive that income.

Thank you.

[The prepared statement follows:]

STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman, there is a great deal of interest among farmers in the Payment In Kind program. Participation could be quite high, thus drawing down our present huge surpluses, and reducing the mammoth budget outlays for farm programs that we saw last year and will see again this year. In short, PIK just might work. But it also might not. There are still some unanswered questions among producers. I hope that Congress can move quickly to remove the question mark from tax status of PIK commodities, for this issue has brought signup to a screeching halt in many areas.

PIK is a substitute for, and therefore ought to be equivalent to, a normal crop. The farmer agrees to forego production in order to help cut surplus production; and he is compensated "in kind," with a certain percentage of what he would normally have grown on the idle acres. It seems to me only logical to treat receipt of PIK as the equivalent of harvesting a crop. A farmer has income when he sells his cotton, not when he strips it. The same reasoning applies to estate tax treatment of farm property—if the farmer idled his acreage under the PIK program, there was nevertheless a certain "production" associated with it. For these reasons, the subcommittee's favorable action on H.R. 1296, of which I am a co-sponsor, is urgently needed.

Let me briefly mention two other concerns. First, there is some question whether cotton and rice cooperatives which market commodities for many producers would be at a tax disadvantage simply because they might be handling a commodity not physically "produced" by one of their members—i.e., non-member business. I think the subcommittee would do well to consider appropriate action to clarify this situation.

Second, let me urge you to be most cautious about doing anything which might tend to set a monetary value on PIK. USDA's authority for carrying out this program depends on their assumption that there is not a definite, set value associated with these commodities. We risk jeopardizing the program if we upset the assumption.

Thank you, Mr. Chairman.

Chairman STARK. Thank you very much.

Now, Mr. Bedell.

STATEMENT OF HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. BEDELL. Thank you, Mr. Chairman.

You have already heard from a number of people, and I have a prepared statement, but I will not burden you with going through that prepared statement.

I would just simply reiterate that the importance of having a farm program which will be effective. Without this change in the law, I think it is quite clear the program simply will not be effective.

I should point out that not only is this important to farmers, it is extremely important to our taxpayers because of the tremendous burden that they have in paying the costs of interest and storage on the large surpluses that we now have.

I would point out further that all the farmers are asking is that this grain they get be treated the same as the grain which they would raise. Some of them are particularly concerned that the legislation also include provisions that preclude their losing existing estate tax exemptions. I understand Mr. Chapoton indicated he did not think that was a problem, but the important thing is whether the farmers perceive it as being a problem. If the IRS agrees that PIK should not jeopardize their inheritance tax, then it seems to me it is better for you to take those steps.

I cannot thank you enough for holding these hearings and for moving forward on this matter.

[The prepared statement follows:]

STATEMENT OF HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. Chairman, I appreciate this opportunity to appear before the subcommittee today to urge the prompt approval of H.R. 1296, introduced by Congressman Harkin. For fear of holding up this legislation any more than is necessary, my statement will be brief.

I believe that by now you are familiar with the general scope of the payment-in-kind (PIK) program announced by the U.S. Department of Agriculture and the disastrous effect which the recent IRS ruling has had in bringing PIK program signup to a virtual standstill. The majority of my farmers out in Northern Iowa are anxious to participate in the PIK program. They understand that they must reduce production if we hope to get our agricultural surplus down to manageable levels and put our farm economy back on its feet. But they simply cannot participate as long as this cloud hangs over PIK program benefits.

To many of my farmers, the recent IRS ruling on the tax consequences of the PIK payment has made the federal government appear—and rightly so—as though its left hand does not know what the right hand is doing. They are baffled by attempts on the part of USDA to implement an effective acreage reduction program, only to have the program apparently undermined by the IRS. Farmers are looking to the Congress to make some sense out of our federal farm policy.

Farmers are not seeking any special tax treatment. They are merely asking that PIK benefits be treated as crops that the farmers would have otherwise produced. This consistent tax treatment is important because farmers operate on a cash basis, and usually recognize income only when the crop is sold or marketed through livestock. Similarly, crops that a farmer may receive as a crop share payment for land rented to another farmer are taxed only when those crops are sold by the landlord/farmer.

In addition, farmers are seeking assurance that receipt of the PIK payment will not in any way disqualify them from having their land valued under the special use valuation provision for estate tax purposes.

I appreciate the fact, Mr. Chairman, that there are other major issues pending before the Ways and Means Committee. But as I have outlined, there is an urgent need to bring some order and common sense to our federal farm policy, and I hope and respectfully request that the consideration of this legislation be expedited so that we can have an effective farm program in 1983.

Thank you.

Chairman STARK. Thank you much.

I am pleased to welcome Ms. Smith from Nebraska to the committee this morning. We have your prepared statement which will be part of the record.

Would you proceed in any fashion you would like?

STATEMENT OF HON. VIRGINIA SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Ms. SMITH. I thank you, Mr. Chairman, and members of the committee. I will summarize very quickly.

I, too, am grateful to you for holding these hearings. I am not a tax lawyer, and I will not comment on the legal wisdom of the IRS decision. But as a farm State Congresswoman and as a farmer myself, I can tell you in no uncertain terms that the IRS decision was not based on commonsense.

As it has been pointed out, the purpose of the PIK program is to reduce our bulging crop surpluses, to turn back these commodities on the same basis that a farmer would have them if he had raised them. It will not only help the farmers, as Mr. Bedell, my good colleague, says, but it will help everybody in our rural areas.

For those who are not close to the farm situation, let me say it is as important in farm States as a jobs bill is in areas of highest unemployment.

As a lifetime farmer myself, I know so well that this basic problem deals with the fact that many, many producers over the years develop a system whereby they sell their crops produced in one year during the following year. And if they have to declare PIK commodities as income to the IRS in the same year, they are going to have double taxation in 1983. So they will not participate in the program.

This ruling is absolutely in direct opposition to the purposes of PIK.

So I do thank you for the hearing and urge your favorable and quick consideration of this legislation.

[The prepared statement follows:]

STATEMENT OF HON. VIRGINIA SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

I thank the Chairman, Mr. Stark, and all the Subcommittee Members for scheduling this most important hearing. It is imperative that you and the full Ways and Means Committee mark this Payment-in-Kind—IRS legislation as soon as possible.

Mr. Chairman, I am not a tax lawyer so will refrain from commenting on the legal wisdom of the IRS decision to tax PIK commodities when they are eligible to be received. However, as a farm state Member of Congress I can tell you in no uncertain terms that the decision is not based on common sense.

The PIK program has been sold to Congress and to producers as a way for them to reduce production, help bring supplies back in line with demand, and at the same time receive payments for idling ground in the form of commodities that they can use as if they were grown on the farm.

I bring to the Committee's attention the remarks of President Ronald Reagan on December 9, I quote, "They would then be paid in kind from our bulging Government surpluses. In other words, they would be paid in bushels of the same surplus commodity they might otherwise have grown. These farmers would then have full discretion to feed, sell, et cetera, the commodity received as Payment-in-Kind" unquote.

Again on December 9, before the Senate Agriculture Committee and on December 16, before the House Agriculture Committee, Secretary of Agriculture, John Block, said—and I quote again, "The actual value of the in-kind payment would depend on

how and when a farmer chose to market the commodity received . . . just as it would on any commodity that farmer actually produced.

The IRS ruling, while it may be consistent with tax law, is obviously in direct opposition to the objective of the PIK program; a program that was passed by the House during the lame duck session.

I know that many Members of this committee are not familiar with the farm situation or the significance of the Payment-in-Kind program.

To put things in perspective for those of you not familiar with farm programs—PIK is as significant to Farm states as a comprehensive jobs program is for urban states with high unemployment.

The USDA economist, Bill Lesher, opened his testimony before my Agriculture Appropriations Subcommittee by saying that the Nation's largest industry, agriculture, will be facing the fourth straight year of depressed income—this is not doom and gloom politicians—but the economist saying these words.

I have just returned from my District where I can sense a real feeling that the Government is trying to help the situation through PIK. Let's not ruin that perception by letting IRS get in the way of its success!

The basic problem involves income tax, although there are other problems with estate taxes and coop taxes. Many producers have over the years developed a system wereby they sell their crops produced in one year—the following year. For example: last years corn crop grown and harvested in 1982 is being marketed in 1983.

Now, if they participate in the PIK program they will be taxed on the PIK payment in 1983 as well as the crop they grew last year and are marketing this year. It amounts to double taxation in one year based on false income.

The prospect of double taxation has ruined the economic advantage of participating in the crop reduction program in favor of full production. This is exactly what we do not need. Many counties are reporting a standstill in producer sign-up because of the tax questions.

In conclusion Mr. Chairman and members of the Committee, the Administration supports this tax code change, Members of Congress from both sides of the aisle and in both Houses support this change, and farmers not only support, but desperately, need the change.

I urge the Committee to proceed forthwith and bring this legislation to the floor under a closed rule so that we can help rural America help itself. Time is of the essence as producers need to know by March 11, what to expect—their economic lives depend on it.

Chairman STARK. Thank you very much.

Our next witness is the Honorable Richard Durbin from Illinois, who, I must apologize, was here first to testify, and we saved the best for last, and I appreciate your patience.

You may proceed in any manner which you desire.

STATEMENT OF HON. RICHARD J. DURBIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS, ACCOMPANIED BY ROBERT BELLATTI, ESQ., SPRINGFIELD, ILL.

Mr. DURBIN. Thank you very much, Mr. Chairman. I am honored to appear before your subcommittee today, and I thank you and commend you and Chairman Rostenkowski for bringing this matter up for early hearing.

I am joined today by a worthy second, attorney Robert Bellatti of Springfield, Ill., who has been indispensable in my work on this bill and cosponsorship, was kind enough to come today and help.

I think this subcommittee and the Committee on Ways and Means as well as the U.S. Congress, is serving as a bridge, perhaps, between Agriculture and Treasury. On one hand, the Department of Agriculture, I think, has a very promising program and one supported very heartily within my district, and one that I think will go a long way to put the farm sector back on its feet.

Yet, on the other hand, the Department of Treasury, through the Internal Revenue Service, has issued an opinion or ruling which in my mind defies logic and has jeopardized this program.

I have found in the district that there is considerable concern among the farmers as to whether or not they should sign up for the program. I commend you for bringing this matter up early.

Rather than read the whole statement, I would like to call your attention to the second to the last page and ask the subcommittee and through its staff perhaps, to consider one aspect of this legislation which is before you today, which may be worthy of some comment and investigation.

Mr. Bellatti brought this to my attention. It relates to the effective date of the legislation. It currently has an effective date of December 31, 1982, for those dying after that date. We would suggest to the subcommittee that they may consider amending that date to December 31, 1976. In so doing, they will clarify our effort here and make certain that any changes relating to the estate tax will be applicable to those estates already opened, where the administrators or those running the farms may choose to participate in the PIK program.

In so doing, I think it would be a broadening of the concept before the committee, but one that is eminently fair and would set forth, I think, the goals of the program, which is to encourage participation.

The future of the PIK program, and quite possibly the recovery of this depressed farm economy, hinges on our rapid and decisive action in Congress. I commend you for your efforts, and I certainly hope that there is some way we can bring this legislation out of the Congress and to the President's desk as far in advance of March 11 as humanly possible.

Thank you.

[The prepared statement follows:]

STATEMENT OF HON. RICHARD J. DURBIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. Chairman and members of the subcommittee, let me begin by commending both you, Mr. Chairman, and Chairman Rostenkowski for your prompt actions in bringing this important legislation before the Subcommittee on Select Revenue Measures. As a new member of Congress, I am extremely happy to see the House Leadership act in a timely manner on a complication that threatens the success of one of the most important agricultural programs this Congress will face.

I applaud Secretary Block and the Reagan Administration for initiating this much needed program. I must, however, express some dismay over the Administration's handling of this tax question. It would appear that we have one agency of the Administration actively pursuing promising programs to address the plight of the farming sector and the costly storing of grain reserves. At the same time another agency of the administration threatens to cripple the program with a tax ruling which defies simple logic. This lack of coordination has had an adverse effect on the farmers in my district who are deciding whether to participate in the PIK program. With only 16 days remaining for our farmers to decide whether to idle a portion of their farm acreage, it is imperative that a clear, well-defined answer to the tax handling of the PIK commodity come from Washington as quickly as possible.

As I travel the 20th District of Illinois each week, I am impressed by the excitement and enthusiasm expressed by the farmers and farm groups about the PIK program. In my opinion, there are very few other Districts in the nation where acceptance of this program would be more vital.

The 20th District of Illinois harbors four of the top ten corn-producing counties in Illinois. Moultrie, Christian, Macon and Sangamon Counties all averaged over 150

bushels per acre yield in 1982. The yield in these four counties is an astonishing 32 percent higher than the national average for production of corn per acre. My home state of Illinois is second only to Congressman Harkin's home state of Iowa in total production of corn in the United States. You can see the reason for my concern when I sense an undercurrent of skepticism and reluctance in my recent visits to the district. Most, if not all, of this reluctance comes from the IRS's ruling that farmers will have to report the value of the grain as taxable income upon receipt rather than sale and the effect that participation in the program will have on their estates' access to the special use provisions of section 2032A.

The legislation before this subcommittee addresses both of these problems. Section I of H.R. 1296 will satisfy the problem of when the payment-in-kind is to be considered taxable income. It would allow the taxpayer to elect to defer recognition of receipt of the commodity until the sale of the commodity and defer income on any cancellation of any price support loan under the PIK program.

Section II of the bill addresses the estate tax problem. I am advised, however, by an attorney who specializes in farm estate tax from my district, that a few minor alterations may be needed to completely satisfy the estate tax question. The question concerns the effective date of this legislation of December 31, 1982. I would appreciate it if the subcommittee would consider the effect of making the effective date of the amendment retroactive to December 31, 1976. This would make our clarification effort applicable to estates where a death has already occurred and the farm is being operated during the process of settling the estate. I have heard more concern about this aspect of the tax ruling than the income question.

Mr. Chairman, this bill is critical to the eventual success or failure of the PIK program. When Secretary Block testified before the Subcommittee on Credit, Conservation and Rural Development of the House Agriculture Committee on February 14, I pointed out to the Secretary that he seemed cautious in his public statements about the impact of the PIK program. The Secretary's response was that while early indications are that signup will be heavy, he feels that the program could still go either way. I submit to this subcommittee and the full Committee on Ways and Means that the future of the PIK program, and quite possibly the recovery of the depressed farm economy, hinges upon the rapid and decisive action of this committee. Time is certainly of the essence. Again, I commend Chairman Rostenkowski and Chairman Stark for recognizing the urgency of this matter.

Chairman STARK. You made some mention of taking the effective date to 1976.

Is there anything that would prohibit an estate which is operating a farm from participating in the program?

Mr. DURBIN. Could I defer to Mr. Bellatti on that question?

Chairman STARK. Yes.

Mr. BELLATTI. The problem is that the same problems that would be present on qualification of the farmer's estate for the benefits, if he died during this year, would cause a recapture of the tax that has already been saved by the election. As to an estate where somebody has already died, the election has been made, and the part of the farm or all of it is placed in the program. And this would be an immediate imposition of the recapture tax.

It could also possibly trigger an acceleration of the installment payment of estate tax, again for estates where people have already died and made this election. I believe, if I understand the joint committee's report correctly, that the revenue projection of $615 million of cost of this bill for estate taxes under a 1-year PIK program, that is the $615 million. At least, that is the only way I would be able to understand the cost.

It would be triggering recapture—the PIK program, without this bill to cure the tax problem, would trigger a recapture in that amount on existing estates. I did not prepare the statistics, but at least that is how I would read the statistics.

Chairman STARK. I think we are correcting that in the proposal.

My staff tells me that about $385 million of that was due to the triggering, with regard only to the PIK acreage, and that the bill will, we hope, take care of that problem.

Thank you for bringing it to our attention.

I notice that Mr. Evans from Iowa has appeared, and if you would like to join us at the witness table.

If you have a prepared statement, it will be made part of the record, and you may proceed in any way you are comfortable.

STATEMENT OF HON. COOPER EVANS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. EVANS. Thank you, Mr. Chairman.

I am most pleased to have the opportunity, and I am not going to burden you with long remarks, and I will have a statement to put in the record.

I would like to speak briefly and extemporaneously on the subject, and first, to commend the subcommittee on so promptly taking this up.

I am here really in, I guess, two roles. One is as a member of the Agriculture Committee of the House, and one that is vitally concerned with the success of the PIK program in that capacity. I am also here as a corn and soybean farmer from the State of Iowa.

In my capacity as a Member of Congress and of the Agriculture Committee, I would like to relate to you that over this last weekend in the State of Iowa, I had four different meetings with farmers on a variety of subjects relating to agriculture. I want to convey to the committee that the No. 1 instance of frequency of subjects raised in all four of those meetings over the weekend was this subject of taxation under the payment-in-kind program.

I want to impress upon the committee that it is going to have a major impact on participation in that program. While the matter of special use valuation in the States is going to be a factor and is talked about, the No. 1 thing is the treatment of that payment-in-kind receipt as to income taxes. I can assure the chairman that if it is forced upon those people to pay taxes on that grain when it is received, you are going to have a dramatic reduction in the participation.

I would also say that in recent days I have met with the group of people who farm with me. I have an arrangement with five operators to take care of my farm on a crop share basis while I am in the Congress. I think it is relevant to relate to the committee the effect on that group of this issue. It is the only precise gauge I have before and after the issue was raised as to the effects.

When the payment-in-kind program was first announced, we got together, the five operators and myself, and after 30 minutes' discussion, decided that we were all agreed we should go into the PIK program.

Over this last weekend I had calls from one of those five who said, hey, all bets are off, I am not about to take that risk. I could not possibly manage to participate if I were going to be taxed on that payment-in-kind this fall.

I received a call from a second one—so there is two out of the five—who said, gee, I am not sure about this. If it does not get changed, I cannot go in the program either.

I thought that might be a useful statistic to you, Mr. Chairman.

I strongly support prompt action on the very simplest of bills that will directly address these issues before March 11. If the subcommittee feels inclined to do some refinements to the law in other regards, I would strongly urge that that be postponed for a later date.

I thank you very much for the Committee's willingness to listen to me this afternoon.

Chairman STARK. Thank you very much.

If I may, inquire—and if I should not, I can certainly respect the gentleman's feeling of privacy in this. We discussed earlier, before you came, with the Secretary of Treasury a problem that could arise in a situation like yours.

In your present arrangement, is it fair to say that you are the landlord, you own the land?

Mr. EVANS. I am the landlord, and the arrangement for many years has been essentially a crop share lease where I get half the crop, the tenant gets half the crop, we share in the expenses in a variety of ways.

Chairman STARK. There we raised question of how each person gets paid.

If your arrangement with let's just say one operator, to keep it a little simpler here——

Mr. EVANS. They are all the same.

Chairman STARK. Is that you share in the crop and you each take your market risk, then you, in fact, would be receiving a warehouse receipt and be able to postpone income.

Mr. EVANS. Or put it in—yes, yes.

Chairman STARK. Whereas if you received cash in rent for your farm as a share of the crop, you would not.

Mr. EVANS. But you see, I do not receive cash.

Chairman STARK. You have always received crops?

Mr. EVANS. Yes. And nobody who receives cash is going to receive, as a general principle—there may be exceptions, but you either rent for cash or you rent for a share of the crop. If there is a cash rent, I do not think anybody out there is suggesting that payment on that cash ought to be deferred.

Chairman STARK. What we were getting at and the concern we had is that you might—I don't know whether this is a condition—you might hire a harvesting crew, combine crew, to come in, if you did not own one, and you might give them a share of the crop for their service. Yet they really would not be sharecroppers. They are providing a service. I think in some areas of the country historically that is how they are compensated. They get 1 out of every 10 bushels of whatever they are picking or harvesting.

They, then, would be in the position of rather than receiving a cash payment, of receiving a warehouse receipt and being able to postpone income on that.

There were some questions there as to whether that was intended or whether it ought to be just restricted to the farmer, the landowner and/or a tenant under a sharecropping arrangement.

Mr. EVANS. Under the Department regulations, a landowner who shares in the risks under a sharecrop arrangement is considered a farm operator, you see. And so it is the farm operators——

Chairman STARK. What do you do about the person who just provides a service?

Mr. EVANS. This is not at all ever the case in my part of the country. The arrangements that we have, the so-called tenant provides the combine and does the harvesting, and this is part of his input, and he gets paid in the grain that he harvests. But, of course, nobody is going to harvest PIK grain by combine this year. It is going to come out of the bin and not out of the field.

I think the matter has also been raised of people getting this payment-in-kind grain and putting it on a warehouse receipt or putting it in their own bin and keeping it for a number of years to avoid payment of taxes on that receipt.

But I would say to the chairman that it is customary in farm country and has been for years, and there are soybeans in the bin that have been there for 5 years, much to the dismay of the person who put them there. So there is no change in this regard, I think, Mr. Chairman.

Chairman STARK. Thank you very much.

Mr. BEDELL. May I read for you from the Farmers Tax Guide by the IRS just one sentence? It says Crop Shares:

> Rents you receive in crop shares must be included in income in the year the crop shares are reduced to money or the equivalent of money, whether you report on the cash or the accrual method.

So they have clearly stated that in their regulation.

Chairman STARK. Mr. Jenkins?

Mr. JENKINS. I want to thank both of you for your testimony.

I think there is a problem that must be resolved concerning constructive receipt that has concerned some members of the committee which is a little bit different than this as it will apply to PIK payments. It might have been cured by allowing under the program an option as to whether or not the payment was received. The farmer could take the option, receive it this year or next year. That would somewhat cure the policy question that a lot of members have.

But nevertheless, I think the majority of the committee are persuaded that we have to do something because of the situation that exists.

But there is in my own mind, a policy problem that does exist when you receive something in kind. Nevertheless, I support your efforts.

Thank you for your testimony.

Mr. EVANS. We appreciate the opportunity Mr. Chairman.

Chairman STARK. Mr. Duncan?

Mr. DUNCAN. I have no questions.

I thank my two colleagues from Iowa, and we are essentially on the same track. You are fairly well versed in the problems of the agriculture mandate. Your contribution certainly has always been a great help to us. Thank you.

Mr. BEDELL. Thank you.

Chairman STARK. Thank you both.

We have two panels, the first panel consisting of Mr. Larry Werries, the Director of the Illinois Department of Agriculture, and Ms. Gracel Ellen Rice, the assistant director of the National Affairs Division of the American Farm Bureau Federation. And Prof. Neil E. Harl who is professor of agriculture and professor of economics at Iowa State University.

If you all would like to come forward.

STATEMENT OF LARRY A. WERRIES, DIRECTOR, ILLINOIS DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY DICK DAVIDSON AND ROBERT BELLATTI, ESQ.

Mr. WERRIES. Mr. Chairman, members of the Committee. I am Larry Werries, a working farmer from Illinois and currently participating in a little off-the-farm income in the capacity of Director of Agriculture for the State.

I have with me Dick Davidson, who is one of the chief assistants in the Illinois Department of Agriculture, and also Bob Bellatti, who also spoke with Congressman Durbin.

Chairman STARK. Welcome to the committee. As you are listed first—I think all of you have prepared statements which will, without objection, appear in their entirety in the record.

If you would care to summarize those for us or make any additional comments, we would appreciate it.

Mr. WERRIES. I would only reiterate what the three Congressmen from Iowa have already told us about the importance of dealing expeditiously with the two tax measures. I think both are equally important. In being resolved well before March 11, or else I think in Illinois the perception is that the PIK sign-up will be severely and adversely affected.

The coffee shop talk, for example, is that if the 2032A provisions are not dealt with in a manner that is, in the view of the farmers, going the way they see that it ought to, they will just bail out of the program if they have already signed up, and those who are contemplating signing up are going in to those county ASCS offices and seeking information, but they are not signing up. That is the information that we are getting.

Also there is a fear, whether it is based on much justification or not, that if IRS rules that PIK grain should be taxed at the point of entitlement, that the next step would be to tax commodities at harvest time. It seems to make sense that PIK grain should be treated as income when it is sold.

And that is the summation of my comments.

[The prepared statement follows:]

STATEMENT OF LARRY A. WERRIES, ILLINOIS DIRECTOR OF AGRICULTURE

Chairman Stark, distinguished members of this sub-committee, I am Larry Werries, Director of the Illinois Department of Agriculture. I thank you for allowing me the opportunity to appear before you today on these very critical questions that surround the USDA Payment-In-Kind program.

First of all, let me say that as a spokesman for agriculture from the state that leads the nation in agriculture exports and as a result contributes the greatest amount of money toward our balance of trade, I consider the success of the Payment-In-Kind program an absolute necessity for the survival of many of our Illinois farmers.

Farmers in general are good businessmen. They have displayed that in the past and they continue to do so. However, the problem facing them now goes beyond

sound business decisions. If we do not act quickly, we are in danger of losing many of the best producers in agriculture, simply because in its current state, agriculture has lost the potential for profitability.

Foreclosures of farming operations are receiving national attention. Three point three percent of the farmers who have borrowed from the Production Credit Association were behind on their payments as of December 31, 1982. Delinquency rates for Federal Land Bank borrowers were 3.2 percent, contrasted to 2.4 percent at the same time last year. In Illinois, delinquency rates for farming operations financed by Farmer's Home Administration loans is at 15 percent while at the national level the delinquency rate is 24 percent. Statistics indicate the size of the farming operation has no significance. Those in trouble include both small and large farm operations.

Agriculture is a victim of its own success. United States agriculture has reached unprecedented levels of production, but weakened demand for U.S. agriculture products has caused surplus stocks to swell and commodity prices to fall. USDA corn carryover stocks are estimated to be 3.3 billion bushels by October 1, 1983. Without substantial reduction of this supply, it is my opinion there will be no improvement in the agriculture economy.

The Payment-In-Kind program offers the only solution available to farmers to reduce production and the intense pressure of the carryover stocks. It is my feeling, the Payment-In-Kind program is in jeopardy due to the interpretation of the Treasury Department in reference to the Internal Revenue Service Code as it relates to the Payment-In-Kind program.

I have enclosed for the sub-committee, a copy of a "Special Alert" bulletin which was circulated in Illinois this past week by the Illinois State Bar Association. I would like to cite a few of the phrases from the bulletin indicating the mood, surrounding the issue of the application of Internal Revenue Code. Section 2032-A. The headline reads, "Payment-In-Kind Program Creates Possible Estate Tax Trap." The Bar Association says "It appears then that the farmland idled by participation in PIK is not being used for a qualified use. Should the owner die while the farmland is in PIK, the land would not qualify for IRC 2032-A. Also note that this acreage may be large enough to cause problems in meeting the 50 percent and 25 percent tests of 2032-A as to other farmland not in the program. A possibility of recapture in already qualified estates will also be a major concern."

Another tax ruling by the Treasury Department involves the question of when grain received under the Payment-In-Kind program will be considered income for tax purposes. Farmers carefully manage the marketing of their products for a specific time of the year. Without legislation to clarify for farmers when grain received will be taxed as income, it is my feeling producers are not likely to want to involve themselves with the Payment-In-Kind.

In closing, I would like to again express my strong support for the Payment-In-Kind program. I believe it is vital to recovery of the agriculture economy and I urge you to act quickly and favorably to resolve these tax issues.

Thank you Mr. Chairman and members of the sub-committee. I would be happy to answer any questions you may have.

General Practice

Agricultural Law Edition

Volume 1
Special Issue
February 1983

Published under auspices of the Agricultural Law Committee of the ISBA General Practice Section

Statements or expressions of opinion or of comments appearing herein are those of the editors and contributors, and not necessarily those of the association or section.

SPECIAL ALERT

This SPECIAL ALERT has been produced for readers of the Agricultural Law Newsletter because a decision on the 1983 Payment In Kind (PIK) Program must be made by March 11, 1983. It should also be noted that withdrawal from the program after March 11 results in a significant penalty.

Payment In Kind Program Creates Possible Estate Tax Trap

Participation in the recently announced U.S. Department of Agriculture farmland Payment In Kind Program may significantly affect IRC §2032A qualification and recapture. The following interpretation is not that of the Internal Revenue Service, but appears to be a correct interpretation of the statute and regulations.

One of the requirements for §2032A (special farmland valuation) qualification is that the property must be used for a "qualified use." In order to have a qualified use, the decedent or a member of the decedent's family must be "at risk" in the trade or business for five of the eight years prior to death and also on the date of death. There are generally two elements to risk: risk as to price and risk as to production. Participation in the PIK Program eliminates the risk as to production.

It appears then that the farmland idled by participation in PIK is not being used for a qualified use. Should the owner die while the farmland is in PIK, the land would not qualify for IRC §2032A. Also note that this acreage may be large enough to cause problems in meeting the 50% and 25% tests of §2032A as to other farmland not in the program.

A possibility of recapture in already qualified estates will also be a major concern. Except for the two-year period immediately following the date of death, the qualified property must be in a qualified use. If not, recapture is triggered on that property. In situations of this kind, participation in the Payment In Kind Program will require the payback of the estate tax saved on this real estate as a result of the §2032A election.

Legislation may be introduced to remedy this situation but the probability of passage is unknown at this time.

C. Allen Bock
Professor & Extension Specialist
Agricultural Law
University of Illinois
Urbana-Champaign

BEST COPY AVAILABLE

Chairman STARK. Thank you very much.
Ms. Rice, would you like to follow on?

STATEMENT OF GRACE ELLEN RICE, ASSISTANT DIRECTOR, NATIONAL AFFAIRS DIVISION, AMERICAN FARM BUREAU FEDERATION

Ms. RICE. Yes, sir, thank you.

The Farm Bureau is the Nation's largest farm organization. We represent approximately 3 million member families throughout the country in 2,800 counties. Our producers grow virtually every commodity produced on a commercial basis in the country, and they participate in a comprehensive policy development process at the county, State, and national levels.

In January, President Reagan announced the PIK program. Our Farm Bureau members adopted policy supporting PIK as a short-term solution to reduce the record large commodity stocks and cost of Federal farm programs.

We believe that a crop swap program such as PIK should emphasize four major points. It should be viewed as a short-term solution; it should be implemented in conjunction with an acreage reduction program which will provide adequate incentive to encourage producer participation so that supplies, in fact, can be brought into line with demand; it should be implemented so that all payments go to bona fide producers; and it should be structured in a manner that will enhance orderly marketing.

After the PIK program was announced, the Farm Bureau conducted an analysis, and we have estimated that under the PIK program, stocks will be reduced substantially for all PIK commodities, but that 1983 average prices for these commodities will remain basically unchanged from what they would have been without PIK.

However, our analysis also concluded that reduced cash outlays by farmers, because of an overall 6 percent reduction in planted acres, will result in a net farm income increase of between $2 billion and $2½ billion. This is related in part to decreased production costs.

And at the same time, a combination of reduced deficiency payments and storage costs could result in an overall savings to the Federal Government of approximately $1.2 billion in the first year.

The signup program, as you know, for PIK began January 24 and runs until March 11. We have another 16 days for signup. The Farm Bureau is concerned that the uncertainty surrounding the tax treatment of PIK commodities will discourage participation in the program at a time when production cuts must be made to reduce future carry-over supplies.

The subcommittee is well aware of the two problems of the income tax treatment and the estate tax treatment surrounding the PIK program. Bills have been introduced in both the House and the Senate which we support. These bills would require that PIK commodities be taxed in the same manner as commodities actually grown by the farmer. Without this type of provision, I think you have already adequately heard that there are problems with income bunching, problems when farmers are confronted with per-

haps paying income taxes on a crop, paying taxes on two crops in the same year.

Coupled with estate tax problems, we see that the only thing that can reduce the reluctance of farmers to participate is to clarify these issues and adopt legislation such as H.R. 1296.

PIK is very important to us, and we think that whatever steps can be taken to promote participation should be taken. We encourage the subcommittee to look favorably upon this legislation.

[The prepared statement follows:]

STATEMENT OF GRACE ELLEN RICE, ASSISTANT DIRECTOR, NATIONAL AFFAIRS DIVISION, THE AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation is the nation's largest general farm organization. Farm Bureau is organized in over 2,800 counties and represents farmers who produce virtually every commodity grown on a commercial basis in this country. Farm Bureau members, who now number over three million member families in 48 states and Puerto Rico, participate in a comprehensive policy development program at the county, state, and national levels.

In January, President Reagan announced a farm program designed to reduce price depressing commodity stocks and government farm program costs. Known as the Payment-In-Kind program (PIK), the plan allows farmers to reduce their acreage of wheat, feed grains, cotton, and rice by an additional amount above previously announced acreage reduction and paid diversion programs. As compensation for the reduction, the participating farmers receive commodities, rather than cash, as an incentive to participate. The "entitlement date", or time when the farmer is eligible to receive the PIK commodity, is established to correspond to the usual harvest period in each farmer's area.

Farm Bureau supports the PIK program as a short-term solution to reduce the record-large commodity stocks and the costs of federal farm programs. At the 64th annual meeting of the American Farm Bureau Federation held last month in Dallas, Texas, voting delegates of the member State Farm Bureau adopted the following policy on the PIK program:

We support the implementation of a "crop swap" program in conjunction with an effective voluntary acreage reduction program for the 1983 and 1984 crops of wheat, feed grains, cotton and rice to alleviate the problem of our present burdensome, price-depressing surpluses. A "crop swap" program should be:

(1) Viewed as a short-term solution.

(2) Implemented in conjunction with an acreage reduction program which will provide adequate incentive to encourage producer participation so that supplies can be brought into line with demand;

(3) Implemented so that all payments will go only to a bona fide producers;

(4) Structured in a manner that will enhance orderly marketing;

(5) Coupled with an incentive program for foreign buyers.

(6) Implemented so that acres diverted under this program will not be grazed.

The sign-up period to participate in the PIK program began on January 11 and is scheduled to end on March 11. Participation in the program appeared to be proceeding satisfactorily until questions arose concerning the income and estate tax treatment of farmers who received commodities as payments-in-kind. Farm bureau is concerned that the uncertainty surrounding the tax treatment of PIK commodities will discourage participation in the program at a time when production cuts must be made to reduce future carryover supplies.

The Subcommittee is well aware of the two major issues in question:

(1) The possibility that the Intenal Revenue Service, Department of Treasury, may treat commodities received under the program as income, and therefore taxable, in the year that the farmer has a right to receive the commodities rather than when the farmer actually sells them.

(2) The possibility that the special use valuation provisions of Section 2032A, Internal Revenue Code, may be jeopardized by a farmer's participation in the PIK program. Bills have been introduced in both the House and Senate to clarify these issues. The legislation requires that PIK commodities be taxed in the same manner as commodities actually grown by the farmer. Without this provision farmers would be faced with paying income taxes on commodities not yet sold. The provision avoids income bunching and cash flow problems for farmers who quite likely would have no cash with which to pay income taxes prior to the actual sale of the commodities.

Just as important as the income tax provisions of the legislation are the estate tax provisions which would preserve the application of special use valuation of farmland for farmers receiving PIK commodities. Uncertainty has arisen on this point because some have questioned whether participation in the PIK program puts a farmer "at risk" as required under the qualifications for Section 2032A.

We urge the Subcommittee to review pending legislation and to act quickly to clarify the income and estate tax treatment of PIK participants by treating PIK commodities as if they had been grown by the farmer. Legislation must be passed by the Congress and signed by the President prior to March 11. If this cannot be achieved, Farm Bureau urges the leadership of the House and Senate, and the President, to make clear their intentions so that farmers may have the opportunity to make informed decisions on their production plans for 1983.

Thank you for your consideration of Farm Bureau's testimony.

Chairman STARK. Thank you very much.

Professor Harl.

STATEMENT OF PROF. NEIL E. HARL, CHARLES F. CURTISS DISTINGUISHED PROFESSOR IN AGRICULTURE AND PROFESSOR OF ECONOMICS, IOWA STATE UNIVERSITY

Mr. HARL. Thank you Mr. Chairman and members of the subcommittee.

I am Neil Harl, a member of the faculty at Iowa State University. I appreciate the opportunity to appear here and to provide a written report for the record. I would use my few moments to simply summarize the points made in the statement.

I would like to add my note of urgency based upon farmer calls and visits, and visits from attorneys. I can certainly say that this has had a chilling effect upon participation.

I would urge the subcommittee to consider action that by March 11 will have progressed to the point where farmers have a rather clear signal.

I have divided my remarks into two parts. First is a set of three suggested objectives to guide the process, and then a more technical rundown on the problems involved.

With only 16 days remaining, we feel we would be well served with a clear signal that the problems have been solved or they have not been solved so that we do not have a huge educational task in the limited time available. Part of my responsibility is as an educator working with farmers and others. We would appreciate that consideration.

Second, we do believe it is important to maintain what I call fences to prevent others from taking advantage of provisions designed with a particular group or a particular public objective in mind. We think it is important as we deal with all of these issues that we not lower the fence in terms of creating, possibly, incentives and motivations for mere investors.

Third, we are dealing with a very complex set of tax sections. We believe section 2032A alone is well on its way to becoming the single most complicated section in the whole code. We would hope that we would not add to that section an additional layer of problems and additional areas for further interpretation that would make it even more complicated. We fear that will probably be the result anyway, but we simply feel we must make the point here.

In the second major part of our presentation, we lay out what we view as the problems. The first part is the income tax. Very quickly, to summarize, we believe farmers are in three categories rela-

tive to the income tax treatment. The category one farmer is the straightforward case of no grain under loan, who simply receives the distribution in October of this year. We believe the commodity is constructively received income tax wise. We really do not think there is any question about that. We think that is rather clear under tax law even for cash method of accounting taxpayers.

That can, of course, lead to bunching, and for those who may already have recognized income in 1983 from 1982 crop particularly, this is likely to cause them to be concerned. Income averaging is a partial answer, but it is not a total answer because it does not address the total problem, particularly for those who would look at that first $3,000 of nonaverageable income as a barrier.

The category No. 2 farmer is the farmer who has grain under loan, has not made the election under section 77 to report that loan as income. So here we have the phenomenon of a farmer who has a crop, usually the 1982 crop, still not recognized for income tax purposes on the one hand. And we have a loan outstanding on that crop on the other.

We think it is helpful for purposes of discussion to talk about a forgiveness of that loan. It will happen one way or another. That in itself is taxable income. It would occur in the autumn of 1983.

When the crop is later sold, that is another load of income because that 1982 crop is not subject to income tax until sold or forfeited. So we have the potential here for two incomes, one based on the 1982 crop, and the other on the 1983 crop which they did not grow. That is the PIK crop.

We have in the third category the situation where a farmer has corn or wheat or a commodity under CCC storage, has a loan outstanding and has elected to treat the loan as income when the loan was taken out. When the loan is forgiven on that crop, that would be taxable income. When the crop is later sold, there would not be taxable income except to the extent it exceeds or falls short of whatever the reported income was when the loan was taken out.

So we believe it is vital to keep in mind those three different categories of situations and deal equitably with them, for if we do not deal equitably with those three, then we have problems of perceived fairness. We think they should be treated in comparable fashion in all three of the categories.

Very briefly, on the estate tax side, we do believe there are substantial and serious federal estate tax problems, both under section 2032A and also under section 6166. We are concerned—perhaps our concern is greater than that of the Department of the Treasury. But having monitored the rulings and the regulation in this area since the inception of section 2032A in 1977, we believe that there is justification for concern. We would commend to you the material in terms of discussing the problems that we think deserve legislative attention.

I would like to add another point: Thus far the discussion under 2032A has been limited largely to the PIK program.

Now, there is also, as part of the PIK program, a 20-percent diversion. We have had diversion programs before. There was a diversion program in 1982. It was a nonpaid diversion program. Substatively, we have difficulty separating out the 20 percent diversion from the PIK program which is essentially based on top the 20 per-

cent diversion. PIK moves it from 20 to 50 percent or possibly a whole farm.

So we are concerned, and concerned deeply, about the problems that exist with respect to the 20 percent set-aside program which was announced last autumn and which is really separate from but is a necessary condition with respect to participation in the PIK program.

We have had land diversion programs in prior years. We had it in 1982 on a nonpaid basis. And so our concern is that at some point we take a look at this problem because we fear that we have much the same difficulties there that we have with respect to the payment-in-kind program itself.

We also have indicated in our written testimony that we have various problems, relating to such things as cooperative taxation which has been mentioned, the problems of farmers utilizing idle acres for soil and water conservation purposes under section 175, the problems of investment interest and the other problems identified in the written statement.

With that, Mr. Chairman, I am very appreciative of the time I have been given. I would stand for questions that anyone might have. Thank you very much.

[The prepared statement follows:]

INCOME TAX, ESTATE TAX AND SELF-EMPLOYMENT TAX IMPLICATIONS OF "CROP SWAP" OR PAYMENT IN KIND (PIK) [1]

(By Neil E. Harl) [2]

The payment-in-kind (PIK) or "crop swap" program represents a major commitment of the Executive Branch, acting within existing statutory authority, to reduce Commodity Credit Corporation stocks and amounts in the farmer-held reserve to the end that budgetary outlays are reduced and commodity prices strengthened from currently depressed levels. Unfortunately, several income tax and estate tax problems have emerged and apparently are having a chilling effect on participation in the PIK program. Unless those problems are resolved by March 11, or solutions are clearly outlined and substantial momentum toward final passage is evident by that date, the acreage committed to the program would likely fall below expectations. In the belief that a high rate of participation in the PIK program is in the national interest it is hoped that the Congress can act quickly on the necessary remedial legislation.

My testimony is divided into two parts—(1) a brief discussion of three objectives suggested as guidelines in framing the remedial legislation and (2) a discussion of the major income tax, estate tax and self-employment tax problems involved. Because of the short period of time involved between the completion of the bill drafting process and this hearing, specific commentary is not included on the proposed legislation.

I. SUGGESTED OBJECTIVES

The nature and timing of the tax problems identified to date suggest three objectives to guide the development of needed legislation.

First, with only 16 days remaining until the deadline for sign-up in the PIK program, any amendments should be as simple and as uncomplicated as possible in the interests of clarity of communication to farmers. If we had a year—or even a few months—to do so, a major educational effort could be undertaken to communicate the nature of the changes to producers. But with slightly more than two weeks remaining, heavy reliance must necessarily be placed on daily and weekly newspa-

[1] Testimony presented to Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C., Feb. 23, 1983.

[2] Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; Member of the Iowa Bar.

pers, radio and television to get the message to farmers. Producers have become quite aware of the problems involved and are waiting to know if the problems have been resolved. Therefore, I would suggest that the solutions be framed with simplicity in mind in view of the peculiar time constraints involved.

Second, many of the needed changes in statutory law involve provisions available only to bona fide farmers rather than mere investors. It is important, therefore, to maintain the limitations and restrictions that constitute the "fence" to preclude mere investors from taking advantage of the particular provision. I could not commend legislation to the Congress that would represent a significant weakening of those protective limitations.

Finally, and again in the interests of simplicity, I would urge this subcommittee to make a genuine effort in avoiding amendments that would add to statutory complexity. In particular, I would single out Section 2032A of the Internal Revenue Code (providing for special use valuation of land) which is well on its way to becoming the most complex section of the Internal Revenue Code. I can tell you, truthfully, that both taxpayers and practitioners, each in their own way, are struggling to master the enormous amount of legislation enacted since 1976.

II. MAJOR PROBLEM AREAS NEEDING ATTENTION

The unique nature of the PIK program has caused several tax problems to emerge. Those problems are discussed in brief form in the paragraphs following.

Income tax

The Internal Revenue Service has not, as yet, issued a ruling on the income tax treatment of participation in the 1983 payment-in-kind program although a 1960 ruling provides guidance as to some aspects of the income tax treatment to be expected from program participation. That ruling plus basic features of income tax law afford substantial guidance as to the income tax consequences of PIK program participation. Basically, farmers fall into three categories in terms of the income tax consequences of program participation.

Category I—These are farmers with no grain now under loan to the Commodity Credit Corporation and no grain in the three year reserve. For these taxpayers, amounts of grain received in 1983 from the PIK program—or that could have been received in 1983—are likely to be treated as ordinary income in 1983 for income tax purposes. Merely delaying actual receipt of grain until 1984 isn't likely to change the income tax consequences of being taxable income in 1983 if the decision to defer receipt is left up to the taxpayer. That's because the grain would have been "constructively received" in 1983. Constructive receipt makes amounts taxable in an earlier year if there are no significant restrictions on receipt in the earlier year—just the taxpayer's request to delay payment.

Reporting grain received as a PIK payment as income in 1983 would give the grain an income tax basis. If the grain is later fed to livestock, the taxpayer should have an income tax deduction in that year equal to the income tax basis of the grain fed.

Forced reporting of PIK commodity distributions as income in 1983 could result in substantial bunching of income for a significant number of farmers who conventionally realize income from a crop in the year or years following production.

Category II—These are farmers who have grain under CCC loan or in the three year reserve and have followed the practice of treating CCC loans as loans and not as income. For these taxpayers, any forgiveness of the CCC loan amount in 1983 would be treated as ordinary income in 1983. Again, if the loan forgiveness is delayed—at the request of the taxpayer—until 1984, it would still likely be treated as income in 1983.

When farmers in Category II later sell the grain that has been collateral for the CCC loan, the grain would be taxable income in that year. So if the loan is forgiven in 1983 and the grain is sold in 1983, there would be income tax on both amounts—the forgiven loan and the grain that is sold.

Category III—These are farmers who have grain under CCC loan or in the three year reserve and have treated CCC loans as income in the past. For these taxpayers, any forgiveness of the CCC loan amount in 1983 would be treated as ordinary income in 1983. Deferral of the forgiveness until 1984 at the request of the taxpayer isn't likely to change the income tax result of taxability in 1983.

Again, the outcome for many farmers is a significant bunching of income in 1983.

When Category III farmers later sell the grain that has been collateral for the CCC loan, the grain would not produce tax consequences—except to the extent it

exceeds or falls short of the amount reported as income when the loan was taken out.

In all three situations, the potential for bunching of income in 1983 is present, depending upon the timing of crop sales, when loans were taken out and the taxpayer's past treatment of how CCC loans have been treated for income tax purposes. None of the special provisions enacted over the years to permit farmers to delay income tax reporting and avoid the bunching of income seems to apply to the PIK program. Thus, the special election for CCC loans, the special rule for crop insurance proceeds and the installment sale provision enacted in 1980 do not appear to apply to PIK payments. If there is to be a different outcome, it will be up to the Congress to enact new legislation.

Additional income tax consequences flow from the fact that PIK program participation represents, essentially, a cash rent lease of idled acres to the federal government. The deductibility of soil and water conservation expense is limited to taxpayers "engaged in the business of farming." The regulations specify that land under a cash rent lease does not qualify unless the landowner participates materially "in the operation or management of the farm." With owners of land idled under the PIK program receiving commodities fixed in quantity at the time of program sign up, and with no risk of production borne by the taxpayer, idled land is essentially cash rented to the government. Therefore, a question exists as to whether a landowner participating in the payment-in-kind program could deduct soil and water conservation expenditures on the idled land.

If a landlord uses PIK program participation as an opportunity for laying additional tile or making other improvements eligible for investment tax credit, the landlord may encounter an obstacle to claiming investment tax credit. The noncorporate lessor rule (applicable to all lessors of property other than regularly taxed or C corporations) denies investment tax credit unless two conditions are met. The investment tax credit property must have been "manufactured or produced by the lessor in the ordinary course of business" (which is unlikly) or the term of the lease must be less than one-half the estimated useful life of the property and for the first 12 months under the lease the deductions allowable to the lessor must exceed 15 percent of the rental income (not counting depreciation, depletion, interest and taxes). In most instances, the tests are difficult to meet. For new investment tax credit property, the lessor may elect to let the lessee claim the investment tax credit. That option is not open for used property. Consequently, landowners renting land to tenants should review carefully any plans to make improvements to idled land during PIK program participation. PIK payments would appear to be in the nature of cash rent and thus involve application of the noncorporate lesser rule.

There is a danger that PIK commodity distributions or the forgiveness of Commodity Credit Corporation loans would be considered passive income for purposes of the personal holding company tax applicable to regularly taxed corporations. If PIK benefits are considered as "income from rents," and other passive income is substantial in amount, the corporation could encounter the 50 percent personal holding company tax.

Some agricultural cooperatives may encounter problems in handling PIK commodities. For exempt cooperatives, the Internal Revenue Code limits the cooperative to marketing "products of members or other products." If this is not the case, and PIK commodities may not be considered "products of members or other producers," the cooperative could lose tax exempt status. Some authority exists that cooperative members who purchase a product for resale do not bear the risks of production and are not considered producers of that product.

Federal estate tax

Participation in the payment-in-kind or "crop swap" program could result in loss of special use valuation benefits for those who have elected special use valuation and are in the 10 or 15-year recapture period after death. Also, participation in the program could result in ineligibility to elect special use valuation at death as to land that is removed from production. That's because amounts received under the payment-in-kind program are likely to be treated the same as cash rent—there's not risk of production under the PIK program. The amount of payment is based upon cropping history on the farm and that's known at the time of the sign-up.

With special use valuation, the decedent-to-be or a member of the family must be "at risk" with respect to the farm operation. This is required by the "qualified use" test for eligibility. After death, each qualified heir must have the same "at risk" relationship to the farm business under the qualified use test to avoid recapture of benefits except for a two-year grace period immediately after death.

In the pre-death period, the at-risk requirement for special use valuation can normally be met by a member of the family as farm tenant. But in the case of the PIK program, the tenant isn't "at risk" either, on land in the payment-in-kind program.

Thus, to the extent a farm is in the payment-in-kind program, problems could arise with respect to special use valuation eligibility before death and recapture of special use valuation benefits after death, unless Congress acts to change the rules. The potential recapture problem is made more severe because of the position of the Internal Revenue Service that recapture is not proportionate to the amount of land failing to meet the post-death rules to avoid recapture. Rather, the amount of federal estate tax benefits recaptured is nearly always disproportionately large.

It is important to recognize that if the acreage diverted to conservation use is land other than that under special use valuation, the post-death recapture problem may be avoided.

A similar problem exists with respect to eligibility for 15-year installment payment of federal estate tax. To be eligible for installment payment of federal estate tax over 177 months after death, the decedent must have had an "interest in a closely held business" at the time of death. In general, farmland rented under a cash rent lease is not considered an interest in a closely held business. For that reason, land that is idled under the payment-in-kind program may not be considered an interest in a closely held business. During the period of tax deferral, the statute seems to contemplate the existence of a "business" as opposed to a mere passive rental arrangment. If that is the correct interpretaion, land diverted to conservation uses under the PIK program would seem to count against the 50 percent withdrawal or disposition that would trigger termination of installment payment.

Self-employment tax

The general rule has been that amounts received under acreage diversion programs administered by the U.S. Department of Agriculture have been treated as self-employment income to a farm operator or a materially participating farm landlord under a crop share lease. Presumably, the same treatment could be expected under the 20 percent acreage diversion program for 1983. It is unclear how the additional 10 to 30 percent set-aside, and the whole farm base diversion, under the PIK program would be handled.

Chairman STARK. Thank you very much, Professor. I appreciate the testimony of all of the panel. I am noticing an amazing agreement among all of the witnesses who have testified here this morning.

Mr. Jenkins?

Mr. JENKINS. I have no questions.

Chairman STARK. I thank the panel very much for their interest on behalf of their constituents and members. Thank you.

The next panel will consist of Mr. Jimmy Sanford, the treasurer of the National Cotton Council of America; Don Graham and Bill Sims, counsels for the National Council of Farmer Cooperatives; and Charles Frazier, the director of the Washington office of the National Farmers Organization.

Mr. Sanford, I believe we have a copy of your prepared testimony which will appear in the record in its entirety.

If you would like to add to it or paraphrase it, you might also want to address, because I am sure somebody is going to ask you, was it your organization that had something to do with the figures that have appeared in the Washington Post on Sunday last? You might like to comment on those.

You may proceed otherwise in any fashion you prefer.

STATEMENT OF JAMES H. SANFORD, TREASURER, NATIONAL COTTON COUNCIL OF AMERICA, ACCOMPANIED BY DEAN ETHRIDGE, DIRECTOR OF ECONOMIC SERVICES

Mr. SANFORD. Thank you, Mr. Chairman. My statement is brief.

I am Jimmy Sanford. I am a cotton producer from Prattville, Ala., and currently serve as treasurer of the National Cotton Council in whose behalf I appear today.

The National Cotton Council is the central organization of the U.S. raw cotton industry representing cotton producers, ginners, merchants, warehousemen, cooperatives, cotton seed crushers, and textile manufacturers from California to the Carolinas.

Mr. Chairman, we appreciate very much the opportunity to share with you the cotton industry's concerns regarding the tax treatment for payment-in-kind commodities received by producers. First, however, I would like to set the record straight regarding the recent press reports describing how the PIK program will benefit certain large cotton producers as referred to earlier.

We are aware, of course, that an article which appeared in the Washington Post earlier this week has raised some questions. According to that article which cited a study prepared by the National Cotton Council, the payment-in-kind program will, and I quote, "allow some large cotton growers in the west almost to triple 1983 profits to more than $1 million per farm."

This simply is not true. The error, I am sure, was a result of an oversight which unfortunately made a tremendous difference in the actual picture. The council study which was contained in a special report entitled "The Economic Outlook for U.S. Cotton"—and I have a copy with me this morning—represented an attempt to have cotton producers identify their options under various farm programs and to enhance their decisionmaking.

The report identified three options, Mr. Chairman: One, not to participate in any farm program; two, participate only in a previously announced 20 percent acreage reduction program; and three, participate fully in both the 20 percent acreage reduction program and the recently announced payment-in-kind, or PIK, program.

In evaluating these three options, the report made clear that, and I quote, "Only variable costs are used in comparing alternatives since practically all fixed costs are incurred regardless of the alternative chosen."

Thus the report for each option shows only net returns over variable costs, not net profits.

To calculate net profits, one would have to go one step further and deduct fixed costs. Unfortunately the Post story assumed net returns over variable costs were equivalent to net profits. While an oversight, again, this had a tremendous impact on the end result, for when fixed costs are included in the equation, which according to USDA amount to over $1½ million for a 5,000 acre cotton farm, instead of a net profit of over a million dollars under the PIK program, as cited in the Post article, the actual result is a loss of over $400,000.

Using the same example, by not participating in the PIK program, that same producer faces a potential loss of over $1.1 million.

We have communicated with the Washington Post in this regard and provided them with additional information, and we believe, like us, they are anxious to set the record straight.

What the PIK program does with regard to cotton is not enhance profits but it does provide a means for avoiding disastrous losses while we go through the difficult period of adjustment.

This underscores the very importance of the program. Cotton producers, like others in agriculture, are under severe economic stress. Every effort must be made to bring supplies into better balance with the demand. And we, as an industry, are strongly supportive of the PIK program for just this reason. This is also the reason we support legislation pending before this subcommittee to clarify the tax treatment of payment-in-kind commodities by requiring all or a portion of such commodities to be considered as taxable income upon receipt rather than when sold would virtually eliminate any chance for the program's success.

It would impose a substantial tax penalty on producers at a time when they are suffering from limited cash flow. Faced with the prospect of a substantial tax liability and no real income to pay the taxes incurred, cotton producers, particularly larger producers, will simply not participate in the PIK program. This means that the PIK program will not achieve the needed adjustment in cotton production. Cotton prices will continue to be subject to downward pressure, the effects of which will be felt by both the large and small growers, and greater Federal outlays will be triggered under the target price provisions of the act thus worsening the present deficit situation.

Further, for those producers who do choose to participate, the present tax liability, unless changed, will force them to sell their commodities upon receipt when prices are at their historical season lows. The result then is to further depress prices and again trigger additional outlays from the target price provisions.

Therefore, we strongly urge the subcommittee to clarify the law, to allow payment-in-kind commodities, including cotton, to be considered as taxable income upon sale rather than receipt.

There is also the need to clarify the law with regard to estate taxes. Under present estate tax law, current use valuation is allowed for land that was being farmed at the time of the decedent's death and is continued in that use by the heirs.

Furthermore, following the death of the principal owner of a closely held business, including a farm, the executor may elect to pay the estate tax plus interest over a period of 15 years. But the land must continue to be farmed. It would be desirable to amend the law to specify that land being held out of production in conserving uses under the PIK or any other paid diversion program is being farmed for purposes of these two provisions of the law.

Again, Mr. Chairman, we appreciate very much this opportunity to share our industry's views.

I would like to introduce my guest this morning, Dr. Dean Ethridge, who is director of economic services with the National Cotton Council. He will be glad to answer any questions.

Chairman STARK. Thank you very much.

Next on our list is Don E. Graham and Bill Sims.

Proceed, Mr. Graham.

STATEMENTS OF DON E. GRAHAM AND BILL F. SIMS, NATIONAL COUNCIL OF FARMER COOPERATIVES

Mr. GRAHAM. Thank you, Mr. Chairman.

I would ask that our statement be included in the record.

Chairman STARK. Without objection, it will be included in its entirety.

Mr. GRAHAM. I really have very little to add other than what has been mentioned here this morning except that I would like to underscore and stress the great interest that farmer cooperatives have in the PIK program, and what we need by way of technical corrective legislation so that this does not result in a tax trap for farmers and farmer cooperatives.

I have with me here this morning my colleague, Mr. Bill Sims, who is an accountant from Peat, Marwick and Mitchell in Lubbock, Tex. Bill would like to make a short statement

Chairman STARK. Proceed.

Mr. SIMS. I am from Kent Hance's district, so I guess I will be repeating some of what Kent said.

We thank you for the opportunities of appearing before you. We do the accounting work for a number of farmers in west Texas, and consequently know how interested they are in this remedial legislation. Farmers obviously have the problem of the timing of income and that is almost universal to every one participating in PIK.

However, there is probably a more critical problem to those involved in sections 2032 and 6166. That is the valuation of farmland and installment payments of those taxes. For those people who are affected by that, it is a disaster to involve themselves in PIK. They are just not going to do it if that looks like a problem.

So we would recommend the resolution of that, preferably before March 11 so the people will know what is happening.

The problems related to farmers cooperatives are involved in the operating on a cooperative basis under section 1381A and the exempt status provided by section 521 of the Internal Revenue Code. There is some concern that products not grown by the patrons will not be patronage income for all cooperatives, nonexempt as well as exempt. However, there is dramatic fear that participation by the exempt cooperative in the PIK program, as has been outlined by the Department of Agriculture, will nullify their exemption.

The reason for that is that the statute 521 limits the business that an exempt cooperative can do to that of business with a producer, not a patron, but a producer. Obviously the products, commodities received from PIK and consequently, dealt with through the cooperative, will nullify that exemption.

So I think it is imperative that we correct that. We have offered in our testimony a technical change to section 521 which will just indicate that the PIK commodities will be handled, be treated as though they were grown on the set aside acres.

Again, we urge the passage of this legislation, and we thank you for the opportunity of appearing.

[The prepared statement follows:]

STATEMENT OF DON E. GRAHAM, MCDERMOTT, WILL & EMERY, WASHINGTON, D.C., AND BILL F. SIMS, PEAT, MARWICK, MITCHELL & CO., LUBBOCK, TEX., ON BEHALF OF NATIONAL COUNCIL OF FARMER COOPERATIVES

Mr. Chairman and Members of the Subcommittee: My name is Don E. Graham. I am a partner in the law firm of McDermott, Will & Emery and I am located in Washington, D.C. Prior to joining this law firm, I served as General Counsel for the National Council of Farmer Cooperatives for more than twelve years. With me today is Mr. Bill F. Sims, a partner with Peat, Marwick, Mitchell & Co. Mr. Sims is in charge of agribusiness in the Southwest for his accounting firm, and is located in Lubbock, Texas. Mr. Sims has had many years of experience in farmer and farmer cooperative tax matters and is a recognized expert in the field of agricultural taxation.

We are pleased to be here today to appear and testify on behalf of the National Council of Farmer Cooperatives.

The National Council of Farmer Cooperatives is a nationwide association of cooperative businesses which are owned and controlled by farmers. Its membership includes 112 regional marketing and farm supply cooperatives, the 37 banks of the cooperative Farm Credit System, and 32 state councils of farmer cooperatives. National Council members handle practically every type of agricultural commodity produced in the United States, market these commodities domestically and around the world, and furnish production supplies and credit to their farmer members and patrons. Two-thirds of United States farmers are affiliated with one or more cooperatives. The National Council represents about 90 percent of the more than 6,400 farmer cooperatives in the nation, with a combined membership of nearly 2 million farmers.

Our purpose in asking for time to testify this morning is to address several problems that the Payment in Kind (PIK) program presents in the tax area for both farmers and farmer cooperative associations.

First of all, we believe that farmers have a problem with the timing of the reporting of income under the PIK program. It appears that commodities received from the PIK program are taxable as of the earliest date the farmer is able to control the commodities and therefore taxable at the market value at that date, rather than when the commodity is actually sold as with commodities which he produced.

The problems related to farmer cooperatives involve two sections of the Internal Revenue Code: Sections 521(b) and 1381(a).

Based on prior Internal Revenue Service rulings, it seems definite that commodities received from the PIK program and marketed through the farmer cooperative would be considered as commodities not actually produced by the particular patron who is marketing them and thus the cooperative would lose the exemption created in Section 521 of the I.R.C. To remedy this unintended hardship, we propose that Section 521(b) of the I.R.C. be amended by adding at the end thereof the following paragraph:

"Treatment of payments received under a USDA payment in kind program—For purposes of this section, any commodity received from, or on behalf of, any member or other producer under a payment in kind program (within the meaning of section 451(f)(3)) shall be treated as a commodity produced by such member or other producer on acreage diverted from agricultural use under such program."

The other concern of farmer cooperatives is that commodities received under the PIK program could be interpreted by the Internal Revenue Service as business which gives rise to non-patronage sourced income. We believe that it should be made abundantly clear that sales of commodities received under a PIK program should be treated for all purposes as patronage sourced income and qualified as, "Gross Income from Farming" (see, for example, Section 6015, etc. of the Internal Revenue Code).

Other tax problems which arises due to a farmer's participation in the PIK program relate to Federal Estate tax rules under Sections 2032A and 6166 of the Internal Revenue Code.

Section 2032A allows a farmer to value the farmland in his estate at its usually lower productive value as opposed to the otherwise "highest and best use" value.

Section 6166 allows the payment of Federal Estate taxes over a period of years.

To the extent an individual participates in the PIK program, that "set aside" portion of his estate (should he die during a PIK year) would not appear to be subject to benefit provisions of Sections 2032A and 6166. In addition, the favorable treatment afforded a farmer's estate under Section 2032A could be partially negated if a qualified heir participates in the PIK program.

The effect under Section 2032A could be that the farmland laid out by the PIK agreement would be taxed at a much higher value than would otherwise be available to the recipients' estate. For example, a farmer who dies within the PIK period who has 1,000 acres of land whose "highest and best use" value is $1,000 and whose crop productive value is $500 and who elects, under PIK, to lay out 50 percent of his land would have this portion of his estate taxed at the $1,000 per acre rate versus $500 on the actively farmed land.

We believe that the tax problems with the PIK program that we have mentioned are serious and unless legislation is passed which resolves these issues prior to March 11, 1983, the PIK sign-up date, it makes sign-up a perilous choice.

Should the Chairman or any of the members of the Subcommittee have any questions, we will be pleased to respond. We thank the Subcommittee for giving us an opportunity to appear.

Chairman STARK. Thank you very much.

Our concluding member of the panel is Mr. Charles Frazier, who is director of the Washington office of the National Farmers Organization.

STATEMENT OF CHARLES L. FRAZIER, DIRECTOR, WASHINGTON OFFICE, NATIONAL FARMERS ORGANIZATION, ACCOMPANIED BY ROBERT H. KAPP

Mr. FRAZIER. Thank you, Mr. Chairman. We do appreciate the opportunity to appear this morning and the fact that the committee is moving quickly to examine the values of H.R. 1296. We support a bill along the lines introduced by Congressmen Harkin, Foley, and others.

I might highlight our testimony very quickly by reminding the committee that we have now experienced 3 years of declining net farm income. Our producers across the land have pretty well responded to the leadership of two or three administrations that have encouraged all-out production. We are today at the mercy of a market that is almost nonexistent, and I would cite one example that pretty well illustrates the position of producers throughout the farming community.

Three years ago the 1980 crop of corn sold for an average of $3.10 a bushel, which incidentally is only equal to or a little less than the total cost of production. Corn following the last harvest was selling at $2.10, $2.15, $2.20 in the heart of the belt. In other words, the market is off a third.

Many farmers are still holding grain from two or three crops out there on the land.

The interest in this PIK program was very strong among our members, regardless of their political attitude or their past interest in farm programs, because it represented an opportunity to reduce these excessive stocks and have a chance for a better market, perhaps in 1984 and 1985.

The IRS announcement has simply taken the life out of that interest, and as many witnesses have already put forth today, we believe it necessary that something be done to reverse the IRS announcement.

With that, I would conclude the statement and be happy to answer any questions.

[The prepared statement follows:]

STATEMENT OF CHARLES L. FRAZIER, DIRECTOR, WASHINGTON OFFICE, NATIONAL FARMERS ORGANIZATION

Mr. Chairman and members of the Committee, the leadership of my organization appreciates this opportunity to appear before your Committee and express our views on H.R. 1296 introduced by Congressmen Harkin, Foley and a number of other Members of Congress. The National Farmers Organization membership consists of producers of wheat, feed grains, livestock, milk and a few other commodities that are not so widely grown. Generally, we represent producers that are in the mid-range in size of their farm operations.

As an organization of producers established under the Capper Volstead Act of 1922, we do not buy and sell commodities. We are primarily engaged in bargaining for better prices in behalf of our members on the sales of their production to the major first purchasers. Our members generally prefer not to depend on Government price support programs for their income. In recent years, however, we have been confronted with a disastrous decline in net farm income as a result of high interest rates, rising costs of production and a leveling off of exports of our major commodities. Mounting surpluses have simply taken the life out of the market. Efficient farm operators who expanded production in response to the encouragement supplied by Government spokesmen predicting ever-expanding foreign markets are now stuck with the consequences.

It would appear that we must find some means to dispose as quickly as possible with these burdensome surpluses before we can expect any upturn in the farm economy. To provide you with a concise example, I point out that the average price received for corn has dropped from a national average of $3.10 per bushel for the 1980 crop to the range of $2.10-$2.25 offered for the 1982 crop following the recent harvest. Approximately one third of all farm producers are in financial difficulty at this time.

In view of the circumstances just described, our members, like a majority of all active farmers, expressed an immediate interest in the new Payment In Kind Program announced by President Reagan on January 11. The new program was recognized as an opportunity to cut back production, cooperate with the Government in reducing its cost of storing CCC-owned stocks and to try for economic survival this year, while hoping for better prices commencing in 1984 or 1985. The program is not regarded as a windfall or, for that matter, as a promise of immediate improvement in market prices. It probably will have to operate for two years to be successful. If there is substantial producer participation in the program, it can contribute to market price improvement in the future.

As the meaning of the IRS announcement on February 7 circulated throughout the farm community, the initial positive interest in the Administration's new program took a decided setback. As of January 1, about 75 percent of all corn and 50 percent of all wheat carried over the new year were still stored on the farms. Most producers, who were not forced by demands for operational funds or obligations that had to be met immediately, have been holding their grain production in hopes of a market improvement.

The IRS announcement has withdrawn an option formerly available to producers who were participating in the CCC price support program. The announcement, if permitted to stand, means that a large number of producers, who otherwise might have decided to come into the PIK Program, will face the demand that tax be paid on marketings for prior years, grain released from regular loans or the Reserve and the PIK Program compensation all in one tax year. The consequences will simply mean that a number of producers who are already facing financial disaster will be forced to forego participation in the new program.

In conclusion, I would emphasize that I appear before you today to urge favorable action by the Congress on legislation drawn along the lines proposed in H.R. 1296. Although a number of us do not possess any special expertise with the tax code, we can assure you that the current farm program, having been designed primarily in response to the budgetary demands of the Congress in recent years, is not sufficient to help us avoid more farm bankruptcies and forced sellouts that are literally destroying the farm production base in this country. The PIK Program may not be a perfect answer to all of our problems, but it is the only game in town at this time. By moving this legislation quickly, you can at least enhance the possibility of success with the PIK Program and provide a reasonable chance that some of our farmers will be around to pay taxes in the future.

We thank you for the time to express our interest in this legislation and offer assistance in developing a final bill.

Chairman STARK. Thank you very much.

Mr. Sanford, if I read your testimony correctly, you say the Post article was inaccurate. While you do suggest that the PIK program could reduce somebody's losses by about two-thirds. If the farmer is losing $1.1 million, he only loses $400,000. So there is some strong advantage.

Would that be about the approximate increase, or would that—would it be fair to extrapolate that and say that if somebody is profitable, operating a profitable cotton operation, that their costs would be reduced by about two-thirds and therefore their profit would go up, maybe not exactly in the same amount. It would not only cut losses, for a profitable farmer it could increase profits?

Mr. SANFORD. If he chose to participate in the program.

Chairman STARK. Assuming we pass this bill.

Mr. SANFORD. Yes, sir.

Chairman STARK. Now, just a couple of other questions.

What in your opinion, just to enlighten me, is an acre of cotton worth in the market today? If I came to Alabama and wanted to buy 100 acres, what do you get for a good acre of cotton land in Alabama today?

Mr. SANFORD. This is highly variable, but I would say that it would be anywhere from $400 to $1,000 an acre.

Chairman STARK. $400 to $1,000. Entirely dependent on production records?

Mr. SANFORD. It is not entirely dependent upon that. You have other outside factors that influence it. Location of the property is one such factor.

Chairman STARK. I am talking about if you are just an investor. You are not concerned about schools or the hunting and fishing or proximity to a city where it might be subdivided. I can tell you pretty accurately in any county you want to name in California what you would pay for wine grape land. I am just trying to hit a figure; $600 an acre?

Mr. SANFORD. That would be a good estimate.

Chairman STARK. How about in west Texas?

Mr. SIMS. I would say $800 to $1,000.

Chairman STARK. Does anybody know what you would pay around Modesto, Calif.? Does anybody want to guess, with the water rights?

Mr. ETHRIDGE. I have been told that it is in the vicinity of $4,000 to $6,000.

Chairman STARK. That is what I kind of thought.

Now, that does pose a little bit different problem for people. I assume that is because that either the crop sells for more or the production is higher, and they, as you all know, get free water which you all pay for and for which we in California thank you. Maybe some day we can change those laws so we won't be ripping you off as bad as we are. That may account for the difference in price.

But I assume that the $300 an acre fixed costs that you were talking about apply more to the $600- and $800-an-acre operation than they do to the $4,000- and $6,000-an-acre operation?

Then I had just a couple other questions.

Mr. ETHRIDGE. I might just say a word or two to that. We had two examples. One was a 500-acre farm, and this used the USDA

belt-wide averages. I would also add that the data contained in our report was developed by USDA and are reflected in this USDA publication that was done for the Senate Committee on Agriculture, Nutrition, and Forestry.

Chairman STARK. We would like to see copy of that.

Mr. ETHRIDGE. We used the belt-wide average on the smaller farm. When we went to the larger farm, we used the figures that USDA has published as being representative for the west.

Chairman STARK. Thank you.

Mr. Frazier, if I could ask you a couple of quick questions in the nature of establishing a record, preface it by saying that the Internal Revenue Service has taken the position that sales of members' produce is not an exempt activity under section 501(C)(5), and then I wanted to ask you if the National Farmers Organization's primary activity is selling agricultural products for its members?

Mr. FRAZIER. Mr. Chairman, the NFO has operated for nearly 25 years as a not-for-profit membership organization. We do not buy and sell commodities. We represent our members in bargaining with the major purchasers in the market, in other words, meat packers, milk companies, grain companies.

Chairman STARK. Are profits generated for your members?

Mr. FRAZIER. We do not make a profit in NFO.

Chairman STARK. Why do you not want to form yourself as a cooperative?

Mr. FRAZIER. Well, many of our members have had experience in cooperatives in the past and they dislike the concept of buying, selling the commodities, hopefully for a profit, and withholding the member's share of profits possibly for distribution as patronage dividends at a later date.

In our organization we necessarily take some fees to finance contracting, delivery and handling of the commodities. But we immediately pay the producer what is due him on the sale contract.

Chairman STARK. Would it be fair to say that your primary activity is not selling agricultural products for your members, but that your primary function is the general betterment of your members? Would that be a fair statement?

Mr. FRAZIER. Yes, sir.

Chairman STARK. Thank you very much, Mr. Frazier.

Mr. FRAZIER. I am accompanied by Mr. Robert H. Kapp of Hogan & Hartson. If there are any detailed questions, I am sure——

Chairman STARK. I think that Mr. Jenkins had some interest in some legislation concerning this particular area, and I think those answers to your questions have pretty much covered that.

Mr. Jenkins, did you wish to inquire of the panel?

Mr. JENKINS. I think you have done a good job of covering the difficulties that this association, NFO, had with Internal Revenue.

They have previously ruled in NFO's favor on two occasions, if I remember correctly, and then later they reversed themselves in the 1960's and said they did not qualify.

Are you still in such limbo that you are operating under an adverse ruling?

Mr. FRAZIER. Yes, we are. We were labeled a tax-exempt organization in 1957. And in fact, our status was reviewed and reaffirmed

at a later date. But in the early 1970's our tax-exempt status was withdrawn by administrative decision in the IRS.

Mr. JENKINS. And some of the business leagues really do some of the same things that you do, and they are defined, as I understand it, as tax exempt organizations.

Mr. FRAZIER. That is correct. I should like to ask Mr. Kapp to respond quickly to that question.

Mr. JENKINS. I think there was a tuna boat association I had some knowledge of that does basically the same type of marketing services that you do, and they are classified as tax exempt, but you are not.

Mr. KAPP. That is correct, Mr. Jenkins. There is a district court case in California which holds as tax exempt under section 501(C)(6) of the Code a tuna boat association which engages in collective bargaining on behalf of its members, much in the way that NFO does.

Mr. JENKINS. And of course, labor organizations are tax exempt.

Mr. KAPP. That is another example of an organization engaging in collective bargaining activities, which is exempt under section 501(C)(5) of the Internal Revenue Code.

Mr. JENKINS. What you have asked in the past is that you be treated just like other organizations that perform similar services for its members?

Mr. KAPP. Yes. We would like to be placed on a like footing.

Mr. FRAZIER. If I might add quickly one point, we are quite sure that we would be ruled a tax-exempt organization if we went to court in the matter, but since we make no profits, we do not have standing to go to court with the issue. So we are quite interested in a legislative response.

Mr. JENKINS. I would simply like to clarify it legislatively.

Mr. FRAZIER. Yes, sir.

Chairman STARK. I want to thank the panel for your time. You represent your constituents well, and the committee will resume at 2:30.

This concludes the hearing. We will resume at 2:30 in executive session for the purpose of further consideration of the legislation.

[Whereupon, at 1:25 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C., February 22, 1983.

Hon. FORTNEY H. STARK,
Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR MR. STARK: We wish to express our appreciation for your prompt action to consider legislation dealing with the tax status of farm commodities received by agricultural producers under the new payment in kind (PIK) program.

We strongly urge favorable action on this matter as rapidly as possible so as to encourage participation in the program to help assure that the PIK program will have a maximum chance to succeed in reducing farm surpluses.

The Administration has put the PIK program into effect because American agriculture is in a very severe economic pinch, especially in regions which specialize in some major crops like grain and cotton. Farm prices in recent years have been below production costs for most farmers. Net farm income has been forced down to the lowest levels since the days of the depression of the 1930s, and the Agriculture Department is not forecasting any substantial improvement during 1983. The USDA, for example, recently estimated that net farm income (after inventory ad-

justment) fell from $25.1 billion in 1981 to $20.4 billion in 1982, and may range between $16 billion and $20 billion in 1983. The Department also is predicting that the value of agricultural exports, which are so important to many of our crops, may be down about 8 percent in the current fiscal year.

The price and income crunch which is devastating American agriculture has a number of causes. Without going through the entire complicated picture, it is fair to say that one of the key steps needed to improve the situation must be an effective program to reduce surplus production. There is no disagreement about this need.

The situation we face now is this: Without an effective PIK program, surpluses will continue to accumulate, prices will be depressed further, and more and more of our farmers will be driven off the land. We cannot tell whether the PIK program as currently designed will work as well as the administration hopes, but we do believe that in the interests of farmers, taxpayers and consumers alike we must do what we can to give the program a fair chance to work. This means that we must try to eliminate obstacles to participation in the program.

One major obstacle to participation right now is the Treasury Department's determination that a farmer who receives PIK commodities must consider them as taxable income at the time the commodity becomes available to the producer. This is discouraging farmers from participating because they face the prospect of paying taxes on products from which they have not yet received any cash. The best and most sensible way to correct this situation is through legislation, like H.R. 1433, the bill I have introduced, the bill H.R. 1296 on which the Committee hearing is based, and others, such as H.R. 1287.

In addition, it is important that farmers be able to participate in the PIK program without jeopardizing the benefits to which they are entitled under the estate tax law. These include the provisions relating to valuation of farmland under section 2032A and those relating to the extension of time for payment of estate taxes under section 6166. The bills under consideration would preserve access to these provisions when a producer participates in the PIK program.

Enrollment in the program terminates on March 11, 1983. Early action on this legislation will help make sure that we do not artificially hamper farmer enrollment in the PIK program. That is important because the PIK program itself is, at this moment, our best hope for halting the buildup of crop surpluses and laying the groundwork for an eventual turnaround in our farm economy.

It is important, also, that any PIK tax status legislation approved by Congress should cover more than one year. The Subcommittee should take note of the fact that if we adopt a bill covering only the 1983 crop, we will very likely be back at work on consideration of a 1984 bill within a few months. It appears virtually certain at this point that there will be a PIK program in 1984, and this means that announcements for operations concernting next year's winter wheat crop will have to be made in the summer of this year—and, before that announcement is made, the tax status issue would have to be faced again unless we deal with it now by adopting a multiyear bill.

Thank you for your cooperation in this matter.

With best regards,

Sincerely,

E (KIKA) DE LA GARZA,
Chairman.

EDWARD R. MADIGAN,
Ranking Minority Member.

STATEMENT OF HON. E. THOMAS COLEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. Chairman, on behalf of our nation's farmers, I would like to thank you for finding time in the subcommittee's schedule to consider legislation to change the tax status of grain awards made under the Payment-in-Kind (PIK) program.

The subcommittee's decision regarding this tax matter will have a great impact on farmer participation in PIK, and I believe will ultimately have a real effect on commodity prices in the coming years.

Commodity prices have fallen dramatically in recent years, as production has greatly outrun domestic and international demand. In response to this oversupply problem, Congress and the Administration have fashioned a paid diversion program and the PIK program. Under a combination of these two programs, farmers can divert up to 50 percent of their productive cropland in return for cash and grain payments.

During my many visits to my home district in Missouri, I have found a great deal of support for the PIK program from farmers, and from agribusiness people who depend on a healthy farm economy to prosper. While these groups sometimes have diverse interests, they have joined together in support of the PIK program. Even seed and fertilizer dealers, who will see their short-term volume of business go down, have given PIK their support.

For many farmers, the stakes of this year's harvest are the biggest ever. Production must go down if prices are to go up. I believe that we here in Congress should do everything possible to insure farmer participation in PIK, and reversing this harmful tax ruling is one important step.

PIK provides a good incentive for farmers to reduce harvests and bring them in line with current demand. It also provides an added bonus by drawing down the massive supply of grain in the government-held reserve, which costs the federal government over $40 million a month to maintain.

The effectiveness of PIK will be greatly harmed, however, if the IRS ruling that these grain payments are taxable income upon receipt is allowed to stand. Frankly, this ruling just doesn't make sense. Farmers have always paid tax on their grain when they sell it on the open market. PIK grain should be treated the same way.

Once this grain is sold on the marketplace, it will be entirely appropriate to tax the income from the sale, and provide much the same revenue to the Treasury.

Other, larger questions regarding the IRS ruling and how it potentially affects "at risk" status for family farms should also be put to rest by Congress before the March 11 PIK sign-up deadline.

In conclusion, prompt action by Congress to provide a clearer indication to farmers of the outcome of the IRS income ruling should be provided to our farmers no matter what the final outcome. The stakes are far too high for our farmers to take a chance on a question that can easily be answered by this Congress with due speed.

Again, I thank the Chairman.

STATEMENT OF HON. TOM DASCHLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to testify in support of H.R. 1296, legislation which will remove obstacles to participation in the payment-in-kind (PIK) program announced by the Administration. Because of the urgent need for Congressional action on the tax status of farm commodities received by agricultural producers under ths PIK program, the decision of the Subcommittee to promptly consider H.R. 1296 is greatly appreciated and I urge the Subcommittee to also quickly approve this legislation.

Mr. Chairman, in January, the Department of Agriculture announced the payment-in-kind program to encourge farmers to further reduce 1983 crop acreages of wheat, corn, sorghum, upland cotton, and rice. Under the program announced by the Administration, producers who participate in PIK can elect to either divert from 10 to 30 percent of their crop acreage base from active production or divert the whole crop acreage base for the farm on a bid basis. For participation in PIK, farmers will be compensated by receiving a quantity of the commodity normally planted on the diverted acreage.

The PIK program represents a fundamental change in the agricultural policies of this Administration which for the last two years has chosen to ignore and failed to support congressional proposals for improved commodity supply management. The PIK program is a belated, but needed, recognition by the Administration of the serious and worsening condition of our Nation's agricultural economy.

The objectives of the PIK program are improved supply management and reduced agricultural surpluses. There is no certainty the PIK program as designed by the Administration will be as successful as hoped, but it is certain participation is a key to program success and obstacles to participation must be removed.

In South Dakota, there is substantial interest in PIK, but the indication by the Treasury Department that a farmer who receives PIK commodities must consider them as taxable income when the commodities become available, not when sold, is discouraging program participation. Additionally, the possibility of loss of special use valuation of farmland for estate tax purposes as a result of participating in PIK is also discouraging program participation.

The measure being considered today by the Subcommittee, H.R. 1296, which I have cosponsored, removes these obstacles to PIK participation. This legislation will permit farmers who receive payment-in-kind commodities as compensation for participating in the PIK program this year to defer recognition of income from PIK

payments from the date of availability to the date sold. This measure also preserves access to special use valuation of farmland for PIK participants.

Because of the rapidly approaching deadline for PIK participation, I again commend the Subcommittee for promptly considering H.R. 1296 and I urge the speedy approval of this critically important legislation.

STATEMENT OF HON. PAT ROBERTS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. Chairman, I commend you for convening this hearing on H.R. 1296, a bill to clarify the tax treatment of payment-in-kind program benefits received by farmers. The recently announced PIK program has been very favorably received. While the farmer realizes it won't solve all of the problems in farm country, it is at least a step in the right direction.

However, the reception and response to the PIK program by the farmer has been clouded recently by the tax ruling of the Internal Revenue Service, which would treat the PIK certificate of entitlements as income to the farm at the time they are received. In addition, the IRS has stated a producer could lose the special use valuation benefits for estate tax purposes if he is within the 10 or 15 year recapture period. Furthermore, participation in the PIK program could result in an ineligibility to select the special use valuation of an estate if the recent IRS ruling is allowed to stand.

The payment-in-kind program sign-up deadline date is March 11. By this date, farmers will have to make important financial decisions. For the hard, red winter wheat producer in my district, participating in the PIK program means destroying a growing crop. That is a rough economic decision that can't be made by the farmer when he doesn't know the tax consequences of participating.

The farmer can't make a rational decision on "assurances" from the Treasury and the USDA that the tax problem will be cleared up. In recent years, the imposition of grain embargoes and trade sanctions and the continued mingling of foreign affairs and agricultural policy has made trusting the federal government a perilous propostion. The farmer needs to know now exactly where he will stand in the eyes of the IRS when it comes to the treatment of the payment-in-kind.

This legislation doesn't allow the farmer to avoid any taxes. This legislation would only afford the farmer the same tax treatment on his payment-in-kind grain that is currently made available on the crop produced. This action is necessary to avoid the possibility that farmers may be taxed for two years production in one year. I urge the subcommittee to move expeditiously on this legislation and make every effort to have this legislation out of the House by March 11.

STATEMENT OF HON. JIM SLATTERY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. Chairman and members of the Subcommittee, thank you for your prompt consideration of H.R. 1296, a most important piece of legislation for the American farmer. Without this bill, I am afraid that participation in the payment-in-kind program will suffer greatly. Such an outcome carries with it serious connotations for the intent of PIK, to reduce price-depressing surpluses.

Yet, who can blame farmers for hesitating if they face uncertain tax consequences by signing up?

Any businessman is wary of agreeing to a contract if certain clauses are questionable or vague, and the farmer in the Second District of Kansas is no exception.

I wish to commend Mr. Harkin for his timely response on this matter. The legislation he introduced, and I cosponsored, would end the tax questions that have arisen from the PIK program and an Internal Revenue Service interpretation of current tax law. At the time when the government is seeking to encourage farmers to reduce their planted acreage, the tax laws are raising serious doubts about whether entrance into the program is worthwhile, or may actually be an additional burden.

To me, the bill's assurance of a tax deferral on the PIK grain is simply a matter of equity.

One of the unfortunate economic conditions in agriculture today is that farmers have been penalized for being the most abundant food producers in the world. They are caught between low prices for their crops and high interest rates that threaten many of them with extinction.

I have endorsed acreage reduction programs as part of the answer to bringing commodity supplies back in line with demand. Although our main attention must

be directed toward an aggressive export policy, our agricultural surpluses can be alleviated by an effective acreage reduction plan.

If PIK is to succeed, farmers must have a full understanding of the contract they are signing with the government. The impending March 11 deadline establishes the urgent need to clear up the tax treatment for PIK commodities.

Under the provisions of H.R. 1296, PIK commodities would be treated as if they were grown by the farmer. If the farmer chose to defer taxation of PIK commodities at the time he received them, he could do so. Otherwise, the IRS has ruled, the farmer would have to pay taxes for the PIK commodity in the same year it was received. In effect, without this legislation, farmers would be facing tax payments on two crops in the same year.

This legislation will allow farmers to choose the year in which they would be taxed for PIK commodities. They would have several options, including when they received the commodity, when they sold it, or when they used it to feed livestock.

I hope the legislation will end the doubts that seem to be hampering PIK signups. It will give farmers the necessary latitude to make their own decisions about taxation, and avoid a potentially disastrous signup rate for PIK.

The bipartisan support shown in the House for this legislation, and the strong endorsement on the Senate side, indicates an immediate need for this change in tax treatment. I encourage this subcommittee and the full Ways and Means Committee to take expeditious action on this bill. Passage will assure a troubled farm constituency that Congress is listening.

Again, thank you for the chance to present this statement.

AMERICAN COTTON SHIPPERS ASSOCIATION,
Washington, D.C., February 23, 1983.

Hon. FORTNEY H. STARK,
Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR CHAIRMAN STARK: The American Cotton Shippers Association supports enactment of H.R. 1296 in order to facilitate participation in the PIK Program and to provide equitable tax treatment for American farmers.

Cotton is harvested, ginned and warehoused in the period October through March with sales, shipment and payment to the farmer usually occurring in the first quarter of the calendar year. H.R. 1296 would treat agricultural commodities received as payment-in-kind, for participation in the USDA's land diversion program, just as if they were produced on the PIK recipient's farm. Such treatment would be consistent with current tax policy, which we believe is sound tax policy.

We respectfully request that this letter be included in the Hearing Record of H.R. 1296.

Respectfully submitted,

SAMUEL T. REEVES, *President.*

○